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Politics this week

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Dean quits

AFP

Howard Dean suspended his presidential campaign, in effect ending his bid, after coming a distant third in the Wisconsin Democratic primary. John Kerry won, but by a narrower margin than expected over John Edwards, who now seems the only candidate capable of upsetting the front-runner in the March 2nd Super Tuesday elections, when ten states vote.

See article: John Edwards, still running

Over 2,500 **gay couples** obtained marriage licences in San Francisco. Opponents of the nuptials immediately took the issue to court; local judges said they would hear arguments soon on the constitutionality of the scheme.

See article: San Francisco steals a march on gay marriage

The Democrats won a congressional seat from the Republicans in a special election in **Kentucky**. It is the first time the Democrats have taken a Republican seat in a special election since 1991.

George Bush agreed to set up a private meeting with a national commission that is investigating events leading to the **September 11th** attacks. The panel, which is seeking an extension to its reporting deadline in May, also wishes to interview Dick Cheney, Bill Clinton and Al Gore.

The **Catholic Church** in Los Angeles published a detailed report, stretching back over 70 years, on sexual abuse in the diocese. Meanwhile, a bishop in Phoenix was found guilty of a hit-and-run traffic accident. Thomas O'Brien led the city's 500,000 Catholics until last June, but stepped down once charges were brought.

A trio makes music

The leaders of **Germany, Britain** and **France** insisted that they had no wish to dominate Europe, after a three-way summit in Berlin whose exclusiveness irritated other present and would-be members of the European Union. The trio proposed a vice-presidency for the European Commission to speed reforms of the enlarged Union.

See article: An Anglo-Franco-German club will irritate fellow Europeans

Talks started in **Cyprus** amid mounting speculation that the island's armed stand-off between Greeks and Turks might be settled after 30 years. The United Nations is hoping for a solution before May 1st, when Cyprus is due to join the European Union.

See article: Cyprus, Turkey and the EU

As **Serbia** lurched through a deep political crisis, the former Yugoslav president, Vojislav Kostunica, was expected to form a coalition with a party once led by Slobodan Milosevic, the disgraced strongman of Serbian nationalism who is on trial for war crimes.

Jean-Marie Le Pen, the leader of **France's** far-right National Front, was barred on technical grounds from contesting regional elections in the

AP

southeastern constituency where his party is strong. His rival and former lieutenant, Bruno Mégret, was also disqualified on similar grounds.

See article: Jean-Marie Le Pen barred

Lithuania's legislators moved a step closer to impeaching President Rolandas Paksas when a parliamentary panel concluded that there were adequate legal grounds for such a move. The committee is responding to an intelligence report which questioned the president's business links with Russia.

Iran's vote

A low turnout was expected in **Iran's** election on February 20th, after most reformist candidates were barred from standing. The main reformist parties, including one led by the president' s brother, said they would boycott the poll.

Nearly 300 people died in **Iran** when a train full of fertiliser, petrol and sulphur products crashed and exploded.

Officials from the White House and State Department arrived in **Israel** to discuss Ariel Sharon's proposal for a unilateral withdrawal from the Gaza Strip.

See article: Israelis and Palestinians

The International Court of Justice in The Hague prepared for hearings on **Israel's** controversial security wall. The International Committee of the Red Cross pronounced the barrier contrary to international law.

See article: The World Court and Israel's wall

Declaring, in effect, a state of emergency, **Zimbabwe's** President Robert Mugabe decreed that anyone arrested for public-order offences or for corruption can be held for 30 days without trial.

South Africa's annual budget allocated an extra 2.1 billion rand ($315m) to be used over the next three years against AIDS, and nearly as much again to fight crime.

Sleazy Canada?

Public support for **Canada's** governing Liberal Party fell to a 12-year low in the aftermath of a row over sleaze. Paul Martin, the new prime minister, was expected to put on hold plans to call an early election.

See article: Sleaze and Canada's new government

In **Haiti**, armed rebels opposed to President Jean-Bertrand Aristide seized several more towns in the centre of the country. The United States said Mr Aristide should stay, but admitted that it had little appetite to get involved.

Brazil's president, Luiz Inácio Lula da Silva, sacked a senior aide who was revealed on videotape to have solicited campaign funds in 2002 for the governing Workers' Party from an underworld figure.

See article: A party-finance scandal in Brazil

Peru's unpopular president, Alejandro Toledo, reshuffled his cabinet for the second time in two months and the fifth time since taking office in July 2001. In came seven new ministers, all independent; Pedro Pablo Kuczynski, an investment banker, returns as economy minister.

Talks about talks

Bilateral discussions between **India** and **Pakistan**, dominated by the thorny issue of Kashmir, took place in Islamabad. Delegations agreed upon a timetable for further discussions, starting with more high-level talks in May or June.

See article: India and Pakistan

Nuclear-weapon designs, found in Libya after the country's decision to abandon its programme of weapons of mass destruction, were traced to designs that China sold to Pakistan and then smuggled to Libya. Similar information may have reached North Korea and Iran.

Despite American concerns, Japan signed a $2 billion contract with **Iran** to exploit its Azadegan oilfield.

The death of an aboriginal teenager sparked off riots in Sydney. Angry youths took to the streets of **Australia's** main city after the teenager was impaled on a fence; they claimed that the police were chasing him. Rioters set fire to a railway station and 40 police officers were injured.

AFP

Taiwan's presidential election got under way with a televised debate, the first in Chinese history.

See article: Taiwan's election

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Business this week

Feb 19th 2004
From The Economist print edition

Enron charges

Jeff Skilling, the former chief executive of **Enron**, surrendered to the FBI. He was charged with multiple counts of fraud, insider trading and making false statements to auditors in relation to the collapse of the energy trading giant in 2001. Andrew Fastow, Enron's former chief financial officer, recently pleaded guilty to fraud and received a ten year sentence. Ken Lay, Enron's former chairman, remains under investigation.

Cingular emerged as the winner of an auction for rival American mobile-phone operator **AT&T Wireless** with a cash offer of $41 billion. The merger should help to consolidate a fragmented, and highly competitive, American market. Shares in **Vodafone** jumped as investors showed their relief that the British firm's bid was unsuccessful.

See article: Cingular buys AT&T Wireless

Walt Disney's board rejected an unsolicited $66 billion takeover bid from Comcast, America's biggest cable-TV firm. In doing so, Disney's board offered backing to Michael Eisner, the company's embattled chief executive, but seemed to leave the door open to accepting a higher bid. Meanwhile, Disney added the Muppets to its roster of stars, buying them from the heirs of Jim Henson, the puppet characters' creator, for an undisclosed sum.

See article: Mergers and acquisitions

Kanebo abandoned plans to sell its cosmetics business to **Kao**, a rival Japanese make-up firm, for some ¥400 billion ($3.8 billion). Instead, Kanebo will take a route more usually favoured by Japan's corporate failures and ask for a government bail-out. Kanebo blamed union intransigence in the face of a painful restructuring for the failure of the deal.

Aventis formally rejected a *euro*46 billion ($58 billion) hostile bid from a rival French group, Sanofi-Synthélabo. Aventis's board criticised the offer as “clearly inadequate” and fretted about “important social risks”.

Boss swap

Yukos proposed an unusual asset swap with Russia's government. Big shareholders in Russia's largest oil company offered to give a controlling interest to the government in return for the freeing from jail of Mikhail Khodorkovsky, Yukos's chief executive, and two associates, who are in prison awaiting trial on charges of tax evasion.

An American court ruled that **Tyson Food**, America's biggest meatpacker, had kept down cattle prices illegally between 1994 and 2002 and awarded $1.3 billion to a group of ranchers that brought the case. Tyson wants the verdict set aside and pledged to appeal if it is unsuccessful.

Eight more executives connected with the **Parmalat** scandal, including a son, a daughter and a brother of the company's founder, Calisto Tanzi, were arrested by Italian police as the probe into accounting fraud at the Italian dairy giant widened.

See article: Matteo Arpe, reform-minded Italian banker

Reuters reported the good news that pre-tax profits had hit £49m ($80m) in 2003 compared with a loss of £493m a year ago. Cost-cutting and heavy job losses at the news and information group helped it to recover from a period of decline. Its shares surged by 18%.

Specialist treatment

LaBranche, a "specialist" firm at the **New York Stock Exchange,** agreed to pay $64m to settle with regulators over charges of improper trading. Four other such firms were also tentatively ready to settle and repay another $176m in ill-gotten profits to investors and in fines.

Pimco, a mutual fund owned by Allianz Dresdner Asset Management, became the latest target in investigations of "market timing". Regulators in New Jersey allege that Pimco allowed improper trades by Canary Capital Partners, a big and valuable client.

Bank accounts

Commerzbank, Germany's fourth-largest bank, suffered a surprise loss in the fourth quarter after writing down the value of Eurohypo, its mortgage business. The bank made its worst-ever yearly loss of *euro*2.3 billion ($2.7 billion).

Royal Bank of Scotland, Britain's second-biggest bank, reported that pre-tax profits for 2003 had risen by 29% over the year before to a bumper £6.2 billion ($10.1 billion).

An initial public offering of **Shinsei**, a big Japanese bank that was nationalised and then sold to private investors, attracted enthusiastic demand. Its shares closed at 58% above the offer price on the first day of trading.

Some of America's smaller banks decided to join forces. **National City** said it would pay some $2 billion for **Provident Financial Group**. New York's North Fork Bancorp agreed to buy GreenPoint Financial in an all-share deal worth some $6.3 billion. Retail banking has been popular since the bubble popped.

See article: American banks' new love affair with branches

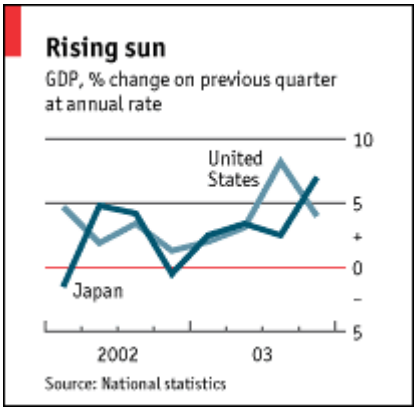
Diving dollars

The **dollar's** slide persisted. The currency hit a new record low against the euro, going above $1.29 for the first time. It also hit an 11-year low against sterling.

See article: Thwarting a rising euro?

Japan's economy grew by an impressive 7.0% in the fourth quarter at an annual rate, its fastest pace since 1990, and by 2.7% for the whole of 2003. The unexpectedly fast expansion was fuelled by robust export growth and investment.

See article: A renewed force in Asia



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Trade and employment

The new jobs migration

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Foreign competition now affects services as well as manufacturing. Good

FOR the past 250 years, politicians and hard-headed men of business have diligently ignored what economics has to say about the gains from trade—much as they may pretend, or in some cases even believe, that they are paying close attention. Except for those on the hard left, politicians of every ideological stripe these days swear their allegiance to the basic principle of free trade. Businessmen say the same. So when either group issues its calls for barriers against foreign competition, it is never because free trade is wrong in principle, it is because foreigners are cheating somehow, rendering the principles void. Or else it is because something about the way the world works has changed, so that the basic principles, ever valid in themselves, need to be adjusted. And those adjustments, of course, then oblige these staunch defenders of free-trade-in-principle to call for all manner of restrictions on trade.

In this way, protectionism is periodically refreshed and reinvented. Anti-trade sentiment, especially in the United States, is currently having one of its strongest revivals in years. Earlier bogus “new conditions” that were deemed to undermine the orthodox case for liberal trade included the growth of cross-border capital flows, the recognition that some industries exposed to foreign competition may have strategic or network significance for the wider economy, and concerns over exploitation of workers in developing countries. Today's bogus new condition, which is proving far more potent in political terms than any of these others, is the fact that international competition is now impinging on industries previously sheltered from it by the constraints of technology and geography.

The new protectionism

It is no longer just manufacturing that is feeling the pressure of foreign competition. It is no longer just dirty blue-collar jobs that are moving offshore. Jobs in services are now migrating as well, some of them requiring advanced skills, notably in computer programming. Services constitute much the larger part of every advanced economy. At the end of this process, what will be left? Gosh, Adam Smith never thought of this. Trade policy needs to be completely rethought.

Well, actually, no. Gregory Mankiw, chairman of the president's Council of Economic Advisers, pointed out recently that if services can be sourced more cheaply overseas than at home, it is to America's advantage to seize that opportunity. This simple restatement of the logic of liberal trade brought derision down on Mr Mankiw's head—and the supposedly pro-trade administration he works for conspicuously failed to defend the plain truth he had advanced. That was disturbing.

John Kerry, who leads the race for the Democratic presidential nomination, is at best a tepid and fluctuating proponent of trade, given to calling bosses who invest overseas “Benedict Arnolds”. His main competitor, the beguiling John Edwards, who did unexpectedly well in the Wisconsin primary this week, has fastened on trade as his winning issue: he is for clenching his jaw and keeping American jobs in America, etc. And the media are simply lapping it up. CNN's flagship business-news programme, *Lou Dobbs Tonight*, which you might expect to strive for economic literacy, has embarked on a rabidly anti-trade editorial agenda, with its host greeting every announcement of lost jobs as akin to a terrorist assault.

The fact that foreign competition now impinges on services as well as manufacturing raises no new issues of principle whatever. If a car can be made more cheaply in Mexico, it should be. If a telephone enquiry can be processed more cheaply in India, it should be. All such transactions raise real incomes on both sides, as resources are advantageously redeployed, with added investment and growth in the exporting country, and lower prices in the importing country. Yes, trade is a positive-sum game. (Adam Smith *did* think of that.)

How disruptive?

The movement of jobs to the developing countries does not alter the overall level of employment in the advanced economies; however, the pattern of employment, to be sure, does change. In the aggregate, this is desirable, just as it is desirable that labour-saving technological progress should change the pattern of employment. (By the way, does anyone still believe that labour-saving technology destroys jobs overall?) So far as the effects on individuals are concerned, this process does have consequences that need to be examined and, in some cases, softened. Adequate private and public investment in skills and lifelong education is paramount in this new world, and is where attention should be focusing. But the image conjured up by the self-interested purveyors of alarm, of a hollowed-out America with relentlessly rising unemployment, is not just false but absurd.

The new jobs migration, while raising no new issues of principle, may indeed involve bigger political and economic strains than earlier bursts of expanding trade. Workers in manufacturing had long understood that they were exposed to the challenge of competition from overseas. Workers in services hitherto believed they were not: it is unsettling to be disabused. Also, it is true that the sheer scale of service-sector employment within an advanced economy arouses anxiety, unwarranted though it may be, about how disruptive the new forces of competition will be.

At the moment, the likely disruption to patterns of employment is surely being exaggerated. The actual and prospective migration of service-sector jobs is small, and likely to remain so, compared with the background level of job creation and destruction in an economy with as much vitality as America's. And technological and geographical constraints will continue to keep many service-sector jobs close to the customer. In some ways, in fact, this is a pity: the greater the disruption, the greater the benefits. As competition forces some jobs in services abroad, it will call forth the creation of new jobs in services in their place. And on average they will be better, higher-paying jobs than the ones that migrate. The evidence shows this is happening (see article). In practice as well as in principle, the fusty old idea of comparative advantage still works.

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India

Let it shine

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It now makes sense to believe that India can emulate China's astonishing march to prosperity

FOR decades, people talked of Asia's economic miracle when what they really meant was East Asia's. First Japan in the 1960s, then the "little dragons", and now even China itself have hauled themselves out of poverty by the miracle of compound growth, which sees increases of 8% a year double national product in under a decade. But the countries of South Asia have remained outside the magic circle. India's billion people have seen only a pale reflection of the astonishing transformation that has affected China's billion-plus. On the crude measure of per capita GDP, Chinese people are twice as productive as Indians.

Many reasons are offered. Some blame the ingrained handicaps of India's caste system, speaking of a "Hindu rate of growth". Some blame the inefficiencies supposedly inherent in democracy. More convincing explanations centre on two phenomena: a half-century of war, hot and cold, between India and Pakistan; and a stubborn reluctance to unleash the power of the market. Thankfully, both are starting to abate.

This week has seen, if not anything that yet looks like peace between the nuclear rivals, then at least the beginnings of something that looks like a peace process. Indian and Pakistani officials have been talking in Islamabad (see article) about a list of issues that includes the relatively easy—getting transport links running regularly across a border that has often been more of a wall—and the extremely difficult, which include the conjoined problems of cross-border terrorism and the disputed status of Kashmir. No one, of course, expects a solution to these any time soon. But the new mood of conciliation might now be profitably turned into a series of negotiations that could rumble on for months or years while rhetoric and provocation is cooled on both sides.

It must always be remembered, though, that relations can easily turn poisonous again. India, which holds the largest and choicest slice of Kashmir, will be the clear winner if, as seems inevitable, any eventual solution more or less reflects the status quo. This does not make for stability: there are far too many dangerous people on the Pakistani side who will feel betrayed and may resort to violence to disrupt the peace process. It would help enormously if Pakistan were seen to be getting something in return for calling off its war. India's presence in Kashmir remains that of an army of occupation, so it could start by finding ways of easing its grip.

A new consensus

But if the hope of peace is still fragile, the signs of economic good sense in India are increasingly robust (see our survey). With growth that could well hit 8% in the fiscal year ending next month, India at last looks to be on the brink of achieving what so many other countries in Asia have managed. Perhaps the main reason for this is that, for the first time, there is now a broad acceptance of the desirability of economic reform. For most of its independent history, India has been run by the Congress Party, which did not cast aside socialism until the 1990s, ten years after the start of China's reforms. More recently, the country has been ruled by the Bharatiya Janata Party, which until only a few years ago was preoccupied with *swadeshi*, or self-sufficiency. These attitudes have not entirely vanished. Foreign ownership of Indian companies is being liberalised only piecemeal. Privatisation proceeds in fits and starts. But both are accelerating: the banking and energy sectors have been opened up already this year, and no fewer than six big sell-offs are promised by the end of March. Economic activities unknown to

Nehru, such as software development, back-office outsourcing, call centres and the like are flourishing unchecked, though more traditional sectors are still being freed only gradually from the suffocating red tape of the old licence *raj*.

So is it really possible that India will be the new China? Perhaps, but only with important caveats. First, India is still far too dependent on the vagaries of the weather. Agriculture counts for almost a quarter of its GDP, and last year's good monsoon was responsible for as much as 3.5% of that thumping growth figure. Tradeable services, the cause of so much excitement, cannot provide the only motor for growth and employment. This kind of work is highly specialised, certainly far more so than low-end manufacturing. On the most optimistic projections, outsourcing will employ 4m Indians, directly and indirectly, by 2008. Yet 9m enter the labour market every year.

The right mix

This means that India's manufacturing sector still has a vital role to play. It is sometimes assumed that China has captured the entire market for cheap manufacturing. That is not the case. Even China's costs will gradually start to rise in the relatively near future, and could do so quite sharply if inflationary and international pressures force it to revalue its currency. There will, anyway, always be room for firms to find a profitable mix of technology and wage costs in any given industry: after all, people still make plates and shoes, not just films and pharmaceuticals, in the United States.

For India to do this, however, it must become a much more attractive place for foreign direct investment. At the moment, China is sucking in about $50 billion of FDI a year, ten times more than India. Those $50 billion will bring China much more than mere cash: they carry with them management skills, technology, marketing and expertise of all kinds greatly in excess of what is available locally. But the investment will not come until India shows that it is serious about improving its dreadful infrastructure, which means better roads, proper airports (compare Mumbai and Shanghai) and reliable power. That cannot be done by a government that is running deficits of around 10% a year. And the deficit problem, in turn, will not be fixed until India sorts out its tax system. Its legal system, clogged and antiquated, needs improvement too.

If these things are tackled, the Indian cobra might join the Chinese dragon in the sun. Some 300m Indians are still mired in poverty. But think back to the China of a decade ago, and a prosperous India is not such an impossible dream.

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Cyprus

Making up is hard to do

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After years of stale rows, the island needs fresh air

AP

WHEN a dispute remains unresolved for a very long time, despite great efforts by well-meaning outsiders to sort it out, that could mean that the parties involved don't really want to see the matter settled. Each side may simply be feigning sweet reason, while nursing a secret hope that the other side will oblige by sabotaging any real progress. Might the future of Cyprus be one of those problems?

Now the island's Greek and Turkish politicians, and their respective "mother countries", have a chance to prove the cynics wrong. Enough progress has been made to convince Kofi Annan, the UN's secretary-general, that a deal to make Cyprus a loose two-part federation—with security and prosperity guaranteed by the European Union—is at last attainable. New talks were to start this week. Both sides are under pressure to strike a deal soon, so all Cypriots can benefit when the EU enlarges in May.

What if there is no settlement by then? In that case, the Greek-Cypriot administration will join the Union alone. So how much incentive, sceptics wonder, do the Greeks have to behave constructively? Quite a lot, if they calculate wisely. Tens of thousands of Greek-Cypriots who were uprooted by fighting in 1974 would regain their homes. The broader Greek-Turkish stand-off would be greatly eased. Besides, if it looked obvious that Hellenic intransigence had wrecked the deal, the Greeks (in Athens and Nicosia) would see their moral authority collapse. That is a big price to pay at a time when competition for influence in an enlarged EU is heating up.

The stakes are high for the Turks as well. If they seem to be digging their heels in, then the people in Europe who oppose Turkey's bid to join the Union will find a new argument. So both sides have strong reasons to take risks for peace.

Can they cross the Rubicon together? It will not be easy for the island's jaded and elderly politicians to move so suddenly. For years, each side has used the (real enough) memory of horrors committed by the other as an argument for caution. On neither side has there been much self-examination. Greek-Cypriots say they were victims, not perpetrators, of the tragic events of 1974: a coup in Nicosia fomented by Greek dictators which prompted the Turkish army to overrun nearly 40% of the island. Turks retort that Greek atrocities in the 1960s gave them good them reason to live behind high walls.

Changing the music

Now these well-rehearsed tunes will have to change. Politicians who have built their careers on ritualised Greek-Turkish conflict will have to plead the interests of an entire, reunited island before the outside world. That is hard to imagine, unless wholly new thinking enters the island's political life.

The most hopeful sign is that ordinary people in Cyprus, especially on the Turkish side, helped to break the logjam. Nearly half the population of Turkish Cyprus took to the streets last year to support a settlement. The catalyst for change in the last few weeks has been a shift of ground by Turkey's generals and politicians. But people power, and the big liberal vote in December's Turkish-Cypriot election, helped to change the mood in Ankara. Indeed, if there are heroes in the island's recent history, it is the moderate Turkish-Cypriots who defied their authoritarian leaders, and in some cases risked jail by daring

to criticise the army. The Greek-Cypriots should respond with a similar generosity of spirit.

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Germany's economy

Odd European out

Feb 19th 2004
From The Economist print edition

Germany is now a relatively poor member of the European club

GERMANY used to be one of Europe's richest nations. In the late 1980s its GDP per head was 20% higher than the average of the European Union. But estimates by *The Economist* suggest that Germany's GDP per head fell 1% below the EU average last year (measured at purchasing-power parity, to take account of differences in prices). Only four of the EU'S 15 members now have a lower income per head. The entry of new members into the EU on May 1st will help to spare Germany's blushes, because these countries' lower incomes will once again push Germany up above a new European average. Nevertheless Germany's relative economic decline has been alarming by any measure. And it looks as if it will continue.

Some of Germany's poor record can be attributed to the reunification of East and West Germany in 1990. At the stroke of a pen this produced a country with average incomes 13% lower than the former West Germany's. Yet this still left income per person for a united Germany 9% higher than the EU average. Since then Germany has been the EU's slowest-growing economy, with an average annual growth rate of only 1.4%—roughly the same as that achieved by feeble Japan over the same period. Japan's economy does at last seem to be perking up, with GDP growth of 3.6% over the year to the fourth quarter. By contrast, Germany's GDP rose by a meagre 0.2%.

Germany's poor economic performance is responsible for much of the under-performance of Europe relative to the United States. It has been common to lambast all European economies as sclerotic. Yet in many ways Europe excluding Germany looks a bit like America. For example, over the past decade GDP per head in the rest of the EU grew by an average of 2.3%—even faster than America's 2.1% average growth. European businesses are often accused of being inefficient and unprofitable, hobbled by high wage costs and red tape. Yet a new study by Goldman Sachs finds that, while corporate America's rate of return on capital is twice that in Germany, the rate of return in the rest of the EU is even higher (see article). And though it is true that European labour markets are in general less flexible than America's, Europe outside of Germany has been creating just as many jobs as America. Over the past decade, employment has risen by an average of only 0.2% a year in Germany, against a rate of 1.3% a year in the rest of the EU, exactly the same pace of increase as in America.

Apologists argue that Germany has not done so badly given the heavy cost of reunification. But this glosses over deeper problems that existed well before reunification. Germany not only has high wage costs, high taxes and an over-generous welfare state, in common with many other continental European economies, it must also cope with the hangover from years of over-investment due to a subsidised cost of capital, thanks to the big role played by state-owned banks. This is why German firms earn such a feeble rate of return on their capital: they invested too much in the past. Now, German firms, just like their Japanese counterparts, are having to reduce their investment as capital costs rise towards normal levels. Germany has other factors in common with Japan. It suffered the biggest fall in share prices after the stockmarket bubble burst in 2000, and house prices have been falling for much of the past decade—just as in Japan.

Wurst to come?

A more efficient use of capital will be good for Germany's longer-term prospects, but for several more years necessarily higher borrowing costs are likely to depress investment and growth. This increases the urgency of labour-market reforms, which would help the economy to adjust with less pain. Even with

reform, however, it looks all too likely that Germany's economy will get worse before it gets better.

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Mergers and acquisitions

Spring in their steps

Feb 19th 2004
From The Economist print edition

Some notes for company bosses out on the prowl

AFTER a long hibernation, company bosses are beginning to rediscover their animal spirits. The $145 billion-worth of global mergers and acquisitions announced in January was the highest for any month since October 2000, and the figure for February seems likely to beat that. Two deals alone (the bids for Walt Disney and AT&T Wireless) account for over $100 billion, and there is a week of the month still to run.

There is now no shortage of chief executives tossing in their beds at night as they contemplate what target they might attack in order to add growth and value to their companies and glory to themselves. They might have been chastened briefly by the excesses of the dotcom boom, but they are once again on the prowl. Hostile bids, the corporate kingdom's way of culling feeble stock, are in favour again (see article). Disney, target of a hostile bid from Comcast, has looked like a three-legged wildebeest for some time now.

What should CEOs do to improve their chances of success in the coming rush to buy? First of all, they should not worry too much about widely quoted statistics suggesting that as many as three out of every four deals fail to create value for the acquiring company's shareholders. The figures are heavily influenced by the time period chosen, and they can never be compared with what would have happened had the deal not taken place. In any case, one out of four is not bad odds when compared with the chances of getting a new business off the ground. So they should keep looking for good targets.

There was a time when top executives narrowed their sights very little. Any type of business was fair game. But in the 1990s the idea of the conglomerate, the holding company with a diverse portfolio of businesses, went out of fashion as some of its most prominent protagonists—CBS and Hanson Trust, for example—faltered. Companies found they could add more value by sticking to their knitting, their “core competence”, although one of the most successful companies of that decade, General Electric, was little more than an old-style conglomerate with a particularly fast-changing portfolio.

Brian Roberts, the man who built Comcast into a giant cable company, has until recently stuck fairly close to his core. His previous big bid was for AT&T's cable systems in 2002. It is not yet clear whether Mr Roberts's bid for Disney is an opportunistic attempt to acquire and break up an undervalued firm, or whether he is chasing the media industry's enduring dream of combining entertainment content with distribution, a strategy which has made fortunes for a few but has also proved the ruin of many big media takeovers.

If vertical integration is Comcast's aim, then it will be imperative for Mr Roberts to have a clear plan of how to achieve that. For in the end, CEOs will be judged less for spotting a good target than for digesting it well, a much trickier task. The assumption will be that, if they are paying big bucks for a business, they know exactly what they want to do with it.

If CEOs wish to avoid some of the errors of the 1990s, they should not forget that they are subject to all the failings that flesh is heir to—and in particular the eternal tendency of business planners to be over-confident. It is a near certainty that, if asked, little short of 99% of them would describe themselves as “above average” at making mergers and acquisitions work. Sad as it may be, that can never be true.

They should also be aware that they will be powerfully influenced by the herd instinct, the feeling that it

is better to be wrong in large numbers than to be right alone. In the coming months they will have to watch carefully to be sure that the competitive space into which the predator in front of them is so joyfully leaping does not lie at the edge of a cliff.

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Letters

Feb 19th 2004
From The Economist print edition

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Poles apart

SIR – How can you claim that the monetary policy of Poland's central bank and its governor "has been a huge success" ("The Balcerowicz effect", January 31st)? You point out that inflation in 2003 was only 0.7%. But there is a wide consensus that it will reach 3.0% by the end of this year. On that basis, the disinflation over the past six years will not have been all that impressive.

More striking have been the other effects of Mr Balcerowicz's mistaken policies. During his tenure as minister of finance between 1997 and 2000, and then as the head of the central bank, Poland's growth rate fell from 7.5% in the spring of 1997 to 0.2% by autumn in 2001. Unemployment has jumped from below 10% then to about 20% now. The central bank's reserves have jumped to almost $33 billion, costing a lot to Polish taxpayers and businesses. Convergence with the euro has been delayed by at least two to three years.

You may praise such a failure as "a huge success" from the perspective of global speculators and hedge funds, which have earned a lot of money from Poland, but definitely not from the viewpoint of the Polish people. Please do not confuse the means of the policy with its ends.

Grzegorz Kolodko
Former deputy prime minister and finance minister of Poland
Warsaw

Divide and school?

SIR – Little attention is given to the ramifications of the proposal to ban Muslim headscarves in French schools ("The war of the headscarves", February 7th). Will Muslim French girls simply attend school without their headscarves once that is the law? Either the policy will discourage attendance, leaving an already proportionately uneducated ethnic minority in France even less educated, or it will lead to the establishment of private Muslim schools where headscarves may be worn, thus institutionalising segregation, which is supposedly what the law seeks to prevent.

Stephen Kooshak
Paris

SIR – Turkey is the only majority Muslim country which has a good chance of joining the European Union and which has banned the headscarf. Why then cannot France do the same? Why is secularism acceptable for the one and not the other?

Carolina Monsalve
Accra, Ghana

The future of fusion

SIR – You say that a large price tag is sufficient to disqualify nuclear fusion as an economical way of generating electricity ("Bouillabaisse sushi", February 7th). This is based on your assumption that the International Thermonuclear Experimental Reactor is an apparatus for the production of energy. In fact, the reactor was conceived as an experimental device for studying the physics of thermonuclear plasmas;

its construction and operating costs are not necessarily those of the fusion reactor that it is supposed to investigate.

The real problem with ITER is more serious. Our present knowledge of plasma physics does not guarantee that it will be capable of reaching the required plasma conditions. Indeed, the reactor is based on a very optimistic extrapolation of the existing data. This, together with our incomplete knowledge of what to expect in the thermonuclear regime, makes ITER a risky project. Failure could cause irreparable harm to the credibility of nuclear fusion.

It is amazing and depressing that a small but vocal minority of fusion researchers were able to convince the governments of many nations to support, to use your technical term, a “boondoggle”.

Ernesto Mazzucato
Plasma physics laboratory
Princeton University
Princeton, New Jersey

Rights to Roma

SIR – One wonders why the EU will admit states like Hungary, the Czech Republic and Slovakia in its latest expansion eastwards, when these states engage in fundamentally racist policies towards their Roma minorities (“Those roamin' Roma”, February 7th). Let us hope that the EU will not allow the entry of Romania, Bulgaria and the states of the former Yugoslavia, where treatment of Roma is even worse.

Turkey is repeatedly refused entry because of shortcomings in its policies towards Kurds and other minorities. Should not the same concern be shown for Roma in eastern Europe? Along with Jews, Roma have been Europe's whipping boys for centuries. Unlike Jews, the situation of Roma has not improved since both groups were rounded up and killed during the Holocaust. Pogroms of Roma villages still occur in south-eastern Europe. The EU speaks the language of human rights throughout the world. It now must back up that language with action at home.

John Dacombe
Ottawa

After a job

SIR – You seem to have swallowed the African National Congress's exaggerated claims about its success in creating jobs over the past decade in South Africa (“Running to stand still”, February 14th). The ruling party claims credit for 2m new jobs. That figure is rounded up from the official estimate of 1.6m—a number which itself is largely the result of a statistical wiggle.

Even COSATU, a trade union which has strong links with the ruling party, rejects the ANC's employment figures. Now the ANC is promising to create 1m new jobs through public-works programmes. Its own documents reveal, however, that almost all of these jobs will involve short-term, one-off stints lasting four months on average—hardly real jobs at all.

The only way to boost job growth in South Africa is to relax our country's restrictive labour laws and encourage the development of small businesses. Having a stronger political opposition in place would also encourage investor confidence in the country.

Tony Leon, MP
Leader of the opposition
Parliament of South Africa
Cape Town

The better man won

SIR – You make unfortunate reference to the voters of Oklahoma as “doltish” for having cast their lot—by the narrowest of margins—with Wesley Clark over John Edwards (Lexington, February 7th). As a registered Oklahoma Republican who did not even vote in the Democratic primary, I am proud that Democrats here had the integrity, whether integrity be doltish or not these days, to cast votes based on issues rather than lavishing a landslide victory on a front-runner for the sake of being a good team

player. If the artless folk of Oklahoma can derail single-handedly the political career of a first-term senator it would be more proper to characterise him as a “never was” than one of the “great ‘might-have-beens'”.

Justin Byrne
Oklahoma City

SIR – Lexington erroneously claims that Andrew Jackson drove John Quincy Adams into early retirement. He did no such thing. After his defeat, Adams was elected to Congress in 1830 and served for 18 years until his death in 1848. Of course, if you are implying that serving in Congress and doing nothing are one and the same, you may have a point.

Andrew Teich
New York

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Israelis and Palestinians

Voices from the front line

Feb 19th 2004 | GAZA AND JERUSALEM
From The Economist print edition

AFP

Stepping back for a moment from the diplomacy, *The Economist* talks to ordinary Israelis and Palestinians about their lives and views

Get article background

AT A party in Tel Aviv, fashionable young Israelis were guzzling wine, smoking joints or washing down ecstasy tablets with mineral water. Trance music drowned the television, but the revellers kept half an eye on the news, just in case. Suddenly, a raven-haired young woman pointed at the screen and shrieked: “There's my tank! There's my baby!”

In many ways, Israel is like any other western society: rich, free and subject to more-or-less predictable laws. Yet it is unlike other western countries in that it has been on a war footing since 1948, the year of its founding. Its colossal defence budget has declined, in relative terms, from 23% of GDP in 1980 to around 10%, now that its most immediate foes are not armies but guerrillas and suicide terrorists. Even this reduced burden, however, is far heavier than that borne by the citizens of any other western country. Israeli taxes are high and, with few exceptions, every Israeli faces two or three years of conscription and decades in the reserves. Israel's streets bustle with machinegun-toting 20-year-olds, its kerbs groan beneath armoured cars, and its nervous restaurateurs have you frisked at the steel-barred door.

The struggle between the Israelis and the Palestinians has captured the world's imagination like no other. It is not the death toll that sets it apart. Some 2,500 Palestinians and 900 Israelis have been killed during the Palestinian uprising, or *intifada*, that started in 2000. That is terrible, but not much by, say, Congolese standards. What distinguishes the Israeli-Palestinian conflict is not the reality, grim though that is, but its symbolism. This is where the modern world's fault-lines meet: divides between rich and poor, secular and religious, Islam and the West.

To many people in poor countries, Israel's treatment of the Palestinians means that the rich always abuse the poor. To many Muslims, it is proof that the West conspires to crush them. To many Jews, Israel is the last refuge for a persecuted people. To some fundamentalist Christians its existence is an essential precondition for the return of the Messiah. Some westerners applaud Israel as the Middle East's sole democracy, a beleaguered ally in the struggle against Islamist terror. Others revile it as the new

apartheid regime.

This last accusation is inexact. Unlike blacks under apartheid, Israel's own Arabs enjoy full political rights. What is more, the Israeli-Palestinian struggle looks less tractable. The South Africans had plenty of land to share, and none of it was holy. White South Africans feared expropriation; Israelis fear extinction. And the Holy Land has no Mandela.

Since the collapse of the peace process in 2000, and despite subsequent efforts to revive it, ordinary Israelis and Palestinians have started to despair. The Israeli government is building a barrier between the two peoples, part wall, part fence—to keep suicide-bombers out, it says. Palestinians retort that these security concerns are a pretext for a land grab (see article). *The Economist* talked to families on both sides, to gauge their mood.

Holy city, unholy dread

David and Shari Greenberg feel pessimistic. A few months ago, a suicide-bomber hit a café near their elegant home in Jerusalem, killing seven people and blowing glass shards and bloody rags into the street. Shari, a writer and musician, was watching a documentary about September 11th when she heard the blast. “It's all too immediate,” she says. “When a bomb goes off, all you do is sit on the phone and call everyone.”

Her husband David, a psychiatrist, reckons that if a blast kills ten people, it may cause psychological damage to 150. Those who show up at his clinic are often traumatised either by physical injuries, or by what they have seen. Shari is nervous, too. “I've taken maybe one bus in the last two years,” she admits.

The Greenbergs came to Israel in 1982, from London, for religious reasons. After a tricky period settling in—“people are very direct here,” says Shari—they grew to love the country's cultural vibrancy, the sense of outdoorsy togetherness forged on youthful hiking trips, and the ease with which they could practise their religion. A small example: had their musical children stayed in Britain, they would have found that the best orchestras all rehearsed on Saturdays. In Israel, schedules are built around the Sabbath.

Although they arrived during a war, the Greenbergs assumed that the fighting would be over by the time their five children were of military age. They were wrong. In 2002, when Israel reoccupied the parts of the West Bank it had given up to the Palestinians, one son was called up during his engagement party and dispatched to the refugee camp at Jenin. “We heard the news of a massacre [of Palestinians], but we knew that wasn't true, because we were getting reports from our son,” says Shari.

The Greenberg children have had to grapple with moral puzzles their parents never faced. “They would have to hold Palestinians at checkpoints, causing great distress,” says David. “Maybe these people were going to hospital, but maybe one was planning to blow himself up.”

The Greenbergs' religious values (they are modern Orthodox) keep them from utter despondency. Secular Jews lack that crutch. Osnat and Aharon Zohar, who live in the small town of Karme Yosef, wonder whether it is worth staying in Israel.

“I was born here, and I'll probably die here,” says Aharon, a consultant. “But, many days, I'm not proud to be Israeli any more.” Three of the Zohars' four parents were Holocaust survivors; Aharon's father was in seven camps and escaped death only because he made excellent shoes.

Aharon believes that Israel's existence is an important insurance policy against history repeating itself, especially given what he hears about a resurgence of anti-Semitism in Europe. But he worries that Israel's control of the West Bank and Gaza is corrupting the country's young.

Military helicopters buzz past. “It's crazy to bring up children in this kind of situation,” says Osnat, a physiotherapist and mother of four. After the stress of military service, the Zohar offspring, like so many young Israelis, go backpacking. When their daughter was in Bolivia, her local guide asked how many Israelis there were. She said 6m. No, he replied, he meant in total, not just in Bolivia.

Osnat and Aharon are doves but, like most Israelis, despise Yasser Arafat. They thought the deal that a former Israeli prime minister, Ehud Barak, offered Mr Arafat in 2000, of more than 90% of the West Bank and Gaza on which to build a Palestinian state, was reasonable. That he rejected it, says Aharon, is a sign that he is not a man who will make peace. (Palestinians tend to remember this offer as less than a quarter of historical Palestine, without the right of return for refugees.)

Nonetheless, Israelis' distrust of Mr Arafat makes it hard to imagine him as a future negotiating partner. When Israeli tanks smashed into his headquarters in 2002, he attracted little sympathy in Israel. Hawks think he got off lightly. “Most people want peace,” says Moshe Shichtman, who runs a deli in Tel Aviv. “But there is a group of bad men, and we have to kill them: Arafat first.”

Moshe is proud to be Israeli, proud to have fought to defend his country (as a tank-commander in Lebanon in the 1980s), and confident that God will protect his chosen people. He thinks military service forges valuable bonds. “In the army, no one knows if you are rich or poor, if you have problems in your family; everyone is the same.” He bangs his fists together. “It's good to be united, to be strong.”

Moshe's parents came to Israel from Romania in the 1960s, fleeing communism, poverty and

persecution. He says he is lucky to live in a free country with terrific weather. He thinks the suicide-bombers are mad, inspired by the devil.

Secular intellectuals might put it differently, but most Israelis tend to share his sense of horror and incomprehension. Black jokes abound. A cartoon in *Ha'aretz*, a doveish Israeli newspaper, shows a Palestinian family looking out from their balcony at a wonderful sunny day. “Let's go for a picnic,” says the father, who has a bomb-belt strapped around his waist. “I'll blow myself up another day.”

Where Moshe differs from the norm is that he says he does not worry much about the risk to himself or his family. “I pray; that's all.” He concedes that life must be difficult for the Palestinians, and says he sympathises, as he believes that most are good people who want peace. He thinks that security measures such as the barrier are justified because they make it harder for the bombers to get through.

Poorer and angrier

Maybe so, but the roadblocks and curfews have made Palestinians poorer and angrier. Israel's economy is the most sophisticated and dynamic in the Middle East, and the Palestinians depend on it. Before the latest *intifada*, 135,000 Palestinians worked in Israel (and the settlements). Most of these workers have now lost their jobs, and the closures have throttled Palestinian exports, too, causing the average Palestinian income to fall by more than half. There are now even more jobless young Palestinian men sitting around with nothing to do but watch the Hizbullah satellite channel.

Their misery and fury are keenest in Gaza, a crowded sliver of land on the border with Egypt, where 1.2m Palestinians live hemmed in by the sea on one side and by the Israeli army on all others. To make matters worse, 7,500 Israeli settlers have grabbed a fifth of the land and blocked many Palestinians' access to the beach.

At the southern end of Gaza, Israel is building a wall as towering as, though much shorter than, the one being erected on the West Bank. It is supposed to stop terrorists digging tunnels to smuggle weapons in and out. Dozens of homes have been flattened to create a buffer zone, leaving a muddy wasteland, on the edge of which lives Abu Ahmad.

It is a risky place to live. A few days ago, he says, his 11-year-old daughter was playing with her friends in the street outside when an Israeli gunner peppered a wall above their heads, showering them with bits of plaster.

Abu Ahmad was born in Gaza, but worked as a cable-joiner in Saudi Arabia for 27 years. He came home in the 1990s, when peace seemed plausible. He was disappointed: “There were not enough jobs, and the PA [Palestinian Authority] does everything by bribery and cronyism.” He says he tried to get one of his sons a job as a [PA] policeman, but was told he would have to pay a bribe, so he gave up.

He thinks Yasser Arafat is “as powerless as any other Arab leader”. He laments that Arabs have never been able to stand up to the West: instead of using their oil wealth to achieve political objectives, they waste it on importing luxury cars and Marlboro cigarettes.

He says he likes Jews and has nothing against Israeli soldiers, either—those who have searched his house have been polite, and he senses that many do not want to be in Gaza. Nonetheless, he approves of “martyrdom” operations against Israeli military targets. Killing civilians, however, is contrary to Islam, he says; such attacks “have caused death and misery without benefiting us in any way.” Suicide bombings will stop, he reckons, when the Israelis pull out of the occupied territories, and he says he would kill any Palestinian who tried to carry out such an operation if the Israelis were to withdraw.

Abu Ahmad sprays kerosene on twigs and lights them to make tea. As he passes round the cups, a loud burst of gunfire rends the evening air. Shortly after, his sons leave. They sleep with relatives, he says, since it is too dangerous here. Then, hospitably, he offers your correspondent a bed for the night.

EPA

Today snowballs, tomorrow petrol bombs?

Your correspondent elects to stay instead with Walid Abu Marzouq, who lives in a quieter part of Rafah. Walid says he has had his homes demolished five times since 1971, mostly in Gaza. For several years he lived a few miles away, in Egypt; but after Egypt and Israel made peace the Egyptian authorities arrested him for smuggling arms into Gaza, and pulled out his teeth and toenails.

He moved back to Gaza in 1999. He built a house by the border, where land was cheap. Four months after he moved in, it was bulldozed. Why? “There were Israeli tanks patrolling the border, and the resistance would shoot at them with AK-47s, using my house for cover. The Israelis responded with heavy machineguns and occasionally shells. I asked the shooters to go away, but they didn't. They were armed, and I wasn't,” he shrugs.

The UN gave Walid another house and helped him set up a little shop in his front yard, but he says he is still paying off debts from his last home. He says suicide-bombers are heroes, even if they kill civilians.

Many Palestinians agree with him. Young men, especially, speak of the incorruptibility of Hamas, the most prominent guerrilla group, and draw unfavourable comparisons with the PA. It is, of course, easy for Hamas to stay cleaner than the PA, as it runs mainly low-budget suicide missions, whereas the PA is trying to govern a fledgling state. If you were a crook, which would you join?

The corollary of this is that murderous extremism has social cachet. No one defaces the posters celebrating “martyrs”. Even those who have nothing to do with the violence aspire to sound like *jihadi*s. In the house of a young maths teacher in Gaza, for example, ten young men, all jobless, loll in front of the TV talking tough. One claims to have attacked an Israeli soldier with his bare hands; the others don't believe him. Another boasts of having served time in jail for political offences. Yet another jokes that your correspondent would be a good person to kidnap.

Even Palestinians who are materially well-off feel wretched. Tayseer Barakat, an artist who runs a café-cum-gallery in Ramallah, in the West Bank, lives in a pleasant and spacious house with a splendid view over a valley. But the view is spoiled for him by the red roofs of a Jewish settlement on the hilltop opposite, and by the daily catalogue of humiliation on the television news.

Shortly after the *intifada* began, he says, his 12-year-old nephew was shot in the eye by an Israeli soldier. Rockets shattered the windows of his café. He cannot visit his family in Gaza, and it is difficult for him to travel abroad to sell his paintings. He cannot use the airport at Tel Aviv, he says, but has to drive all the way to Jordan and board an aircraft there. “Sometimes we don't even have the energy to be sad.”

He believes that the Israelis “want to make our lives so terrible that we will accept anything they offer us,” and that America allows this because the Jewish lobby “more or less controls its policies, especially in this region”. He refuses to condemn suicide-bombers. “The Israelis create these people,” he says.

Demography and despair

Many Israelis have recently started fretting about the “demographic problem”—the likelihood that, within a few years, there will be more Palestinians living west of the Jordan than Jews. Palestinians find this insulting, and jokingly ask parents if their “demographic problems” are well.

If the demographers are correct, Israel cannot annex the occupied territories and still remain both democratic and a Jewish state. Mr Sharon appears to be taking pre-emptive action: earlier this month, he promised to pull the Israeli settlements out of Gaza.

The Gaza settlers protest that a pull-out would encourage terrorism by rewarding it, that it would bruise the morale of the settler movement, and that it would destroy enterprises that, for example, grow 95% of Israel's insect-free lettuce. True, no doubt, but protecting and subsidising these doughty lettuce-growers swallows, by one estimate, the equivalent of a fifth of Israel's defence budget. Their presence enrages Palestinians, and there is no obvious scriptural justification for thinking Gaza part of Israel. A more reasonable objection is that the plan might be part of a larger one to annex chunks of the West Bank. Further conflict seems assured.

For Israelis who do not believe that God has commanded them to live in Israel, the idea of moving to, say, America, where salaries are higher and bombings less frequent, can seem tempting. So far, after three years of recession—the *intifada* coincided with the global tech-stock bust—perhaps 210,000 have left the country. More are talking about it. The most potentially mobile are those Israel can least afford to lose: the bright, best-educated ones.

Some Israelis have even started to doubt whether Israel will survive. “I can't say for sure,” says Aharon Zohar. *Jihadis* may find that encouraging, which in itself augurs badly for peace. Asked if he expects an end to the strife in his lifetime, Walid Abu Marzouq says: “No.”

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The new protectionism

The great hollowing-out myth

Feb 19th 2004 | CHICAGO AND WASHINGTON, DC
From The Economist print edition

Corbis

Contrary to what John Edwards, John Kerry and George Bush seem to think, outsourcing actually sustains American jobs

Get article background

EARLIER this month the president's chief economic adviser, Gregory Mankiw, once Harvard's youngest tenured professor, attracted a storm of abuse. He told Congress that if a thing or a service could be produced more cheaply abroad, then Americans were better off importing it than producing it at home. As an example, Mr Mankiw uses the case of radiologists in India analysing the X-rays, sent via the internet, of American patients.

Mr Mankiw's proposition, in essence, is the law of comparative advantage, first postulated by David Ricardo two centuries ago and demonstrated to astonishing effect since. Yet the Republican speaker of the House of Representatives, Dennis Hastert, joined Democrats in their rebuke of Mr Mankiw for approving of jobs going overseas; another Republican called for his resignation. The White House gave Mr Mankiw only lukewarm support—unsurprisingly, since George Bush recently signed a bill forbidding the outsourcing of federal contracts overseas. And the Democratic presidential contenders? Mr Mankiw had just written their attack ads.

As if to underline the point, this week's Wisconsin primary was dominated by the subject of jobs, and the failure of the Bush administration to do enough to protect them from going off to India. In John Edwards, who wants to rewrite the North American Free-Trade Agreement, the American left may have found its cuddliest protectionist yet; support for the southerner surged after he spent much of a debate drawing implicit comparisons between his own skills as a jobs-defender and those of John Kerry, who has stuck to free trade only a little more loyally. The Democratic front-runner defends NAFTA, but rants about “Benedict Arnold” bosses betraying American workers by moving jobs overseas (presumably to boost returns for fat-cat investors, like, er, Mr Kerry's family).

As for what might be called the business lobby, this is in disarray. “Tech jobs are fleeing to India faster than ever,” moans the cover of *Wired*. Watch “Lou Dobbs Tonight”, America's main business show, and every factory-closing is hailed as proof of America's relentless “hollowing-out” at the hands of dark forces in China, India and indeed the White House. Strangely, no mention is made of the fact that a pretty tiny proportion of all jobs lost actually go overseas.

So what is really happening? Three themes emerge:

•Although America's economy has, overall, lost jobs since the start of the decade, the vast majority of these job losses are cyclical in nature, not structural. Now that the economy is recovering after the recession of 2001, so will the job picture, perhaps dramatically, over the next year.

•Outsourcing (or “offshoring”) has been going on for centuries, but still accounts for a tiny proportion of the jobs constantly being created and destroyed within America's economy. Even at the best of times, the American economy has a tremendous rate of “churn”—over 2m jobs a month. In all, the process creates many more jobs than it destroys: 24m more during the 1990s. The process allocates resources—money and people—to where they can be most productive, helped by competition, including from outsourcing, that lowers prices. In the long run, higher productivity is the only way to create higher standards of living across an economy.

•Even though service-sector outsourcing is still modest, the growing globalisation of information-technology (IT) services should indeed have a big effect on service-sector productivity. During the 1990s, American factories became much more efficient by using IT; now shops, banks, hospitals and so on may learn the same lesson. This will have a beneficial effect that stretches beyond the IT firms. Even though some IT tasks will be done abroad, many more jobs will be created in America, and higher-paying ones to boot.

Just you wait

The “jobless recovery” first, then. Despite strong productivity growth and an accelerating recovery from the recession of 2001 (the economy grew by an annual 4% in the fourth quarter of last year), jobs are being created at a feeble rate of 100,000 or so a month. The jeremiahs point out that a net total of 2.3m jobs have been lost since Mr Bush came to office.

Although this date is often used as the starting-point from which to make a comparison, it is a silly one. In early 2001 the hangover effects from the investment boom of the late 1990s were only starting to be felt. Unemployment, at 4.2%, was unsustainably below the “natural” unemployment rate, consistent with stable inflation, that most economists put at around 5%. In other words, perhaps two-thirds of those 2.3m jobs were unsustainable “bubble” ones. Given the scale of job losses—along with the shocks of a stockmarket bust, corporate-governance scandals and terrorist attacks—it is a wonder that the recession was so mild. By the same token, a mild recession is now being followed by a commensurately mild recovery.

This week, the White House retreated from a claim that 2.6m new jobs would be created this year. But there are reasons to think that job growth will be more robust. In particular, the remarkably strong productivity growth, running at twice its long-run average of 2.1%, must slow down eventually. In the face of rising order books, businesses will have to hire more workers.

This may already be happening in some parts of the country. William Testa, director of regional research at the Federal Reserve Bank of Chicago, points out that the downturn began in the mid-west (because of its relative emphasis on manufacturing, notably business equipment, the mid-west was hit first by the slump in business investment) and then spread to the coasts. Now a recovery is spreading in the reverse direction—starting on the coasts and ending up, alas for Mr Bush, in the key electoral states of the industrial heartland.

In the absence of an obvious jobs recovery, it is perhaps not surprising that the myth arose that the American economy was being buffeted by structural, not cyclical, forces. Yet it nevertheless is a myth—as three notable economists, William Baumol, Alan Blinder and Edward Wolff, point out in a recent book.*

Churning, they point out, has being going on in the American jobs market for years, and “the creation of new jobs always overwhelms the destruction of old jobs by a huge margin.” Between 1980 and 2002, America's population grew by 23.9%. The number of employed Americans, on the other hand, grew by 37.4%. Today, 138.6m Americans are in work, a near-record, both in absolute terms and as a proportion of the population (see chart).

Of course some firms wither—Reynolds Tobacco's workforce shrank by nine-tenths between 1980 and 2002—but others grow: Wal-Mart's by 4,700%. During the 1990s, about a quarter of all American businesses shed jobs in a typical three-month period, equivalent to 8m jobs. Yet jobs created greatly outnumbered these, to the tune of 24m over the decade.

The process leads to incremental shifts that can have profound cumulative consequences for some sectors of the economy. In 1960 only one in 25 workers was employed in the business-services and health-care industries. Today, one in six is. In terms of output, manufacturing has risen, but, thanks to that productivity spurt, these goods are produced by fewer people—12% of the workforce, less than half the proportion of three decades ago.

And what of China? Still piffling. Certainly, China competes with some labour-intensive American industries that have long been in decline, such as textiles and stuffed toys. In the mid-west, metal-furniture makers and small tool-and-die foundries face growing competition. Yet most Chinese imports are of consumer goods, competing with imports from other poor countries, whereas America's manufactures are chiefly capital goods. Even at their peak in 2001, the number of all “trade-related” layoffs represented a mere 0.6% of American unemployment.

As for the Indian threat, “offshoring” is certainly having an effect on some white-collar jobs that have hitherto been safe from foreign competition. But how big is it, really? The best-known report, by Forrester Research, a consultancy, guesses that 3.3m American service-industry jobs will have gone overseas by 2015—barely noticeable when you think about the 7m-8m lost every quarter through job-churning. And the bulk of these exports will not be the high-flying jobs of IT consultants, but the mind-numbing functions of code-writing.

Meanwhile, there is another side to the ledger. Instead of focusing on jobs lost to the globalisation of information technology, Catherine Mann of the Institute for International Economics in Washington looks at globalisation's power to reduce prices and so help spread new technology, new practices and job-creating investment through the economy.

“The creation of new jobs always overwhelms the destruction of old jobs by a huge margin”

She uses the example of cheaper IT hardware, one of the main aspects of globalisation in the 1990s. Most of the drop in prices for PCs, mainframes and so on was caused by the relentless advance of technology; but she still thinks that trade and globalised production—all those Dell Computer factories in China, for instance—was responsible for 10-30% of the fall in hardware prices. These lower prices led to higher American productivity growth and added $230 billion of extra GDP between 1995 and 2002, equivalent to an extra 0.3 percentage points of growth a year.

These days, software spending is increasing at twice the rate of hardware spending, as businesses struggle to make their new computers work better. The manufacturing sector is where such integration has gone furthest. In many other parts of the American economy, the process has barely begun—particularly among smaller- and medium-sized businesses. Mr Mankiw's example of the Indian radiologist shows how the internet could help lower costs and raise productivity in health care. Who would object to that?

Ms Mann concludes that, if IT software sees falls in prices, thanks to globalisation, similar to those that IT hardware has seen, then the second wave of productivity gains—notably in the service sector—could be greater than the first, which was based mainly on manufacturing. Some service sectors, such as construction and health care, are ripe for gains, because their efficient use of IT is low.

Will the trend lead to jobs going overseas? You bet, but that is not a disaster. For a start, America runs a large and growing surplus in services with the rest of the world. The jobs lost will be low-paying ones, such as bank tellers and switchboard operators. Trade protection will not save such jobs: if they do not go overseas, they are still at risk from automation.

By contrast, jobs will be created that demand skills to handle the deeper incorporation of information technology, and the pay for these jobs will be high. The demand for computer-support specialists and

software engineers, to take two examples, is expected by the Bureau of Labour Statistics (BLS) to double between 2000 and 2010. Demand for database administrators is expected to rise by three-fifths. Among the top score of occupations that the BLS reckons will see the highest growth, half will need IT skills. As it is, between 1999 and 2003 (that is, including during the recession) jobs were created, not lost, in a whole host of white-collar occupations said to be particularly susceptible to outsourcing.

Yes, individuals will be hurt in the process, and the focus of public policy should be directed towards providing a safety net for them, as well as ensuring that Americans have education to match the new jobs being created. By contrast, regarding globalisation as the enemy, as Mr Edwards does often and Messrs Kerry and Bush both do by default, is a much greater threat to America's economic health than any Indian software programmer.

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* "Downsizing in America: Reality, Causes, and Consequences," Russell Sage Foundation

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The Wisconsin primary

And then there were two

Feb 19th 2004 | MADISON, WISCONSIN
From The Economist print edition

Could John Edwards still win the Democratic nomination?

WISCONSIN is different, declared Howard Dean. With its progressive tradition and maverick reputation, he claimed, it would not rubber-stamp other states' choice of front-runner. He was right. But it was not Mr Dean who benefited. John Edwards did. His close second-place finish to John Kerry dinged the front-runner's bandwagon. Mr Dean returned to Vermont to suspend his campaign.

So Mr Edwards has what he has long been yearning for: a two-horse race. He has a plausible argument to be a better general-election candidate than Mr Kerry. He has a strategy to keep himself in the contest. But does he have the time and the distinctive policies needed to overtake a front-runner who has now won the last eight contests and 15 out of 17 overall?

Mr Edwards's central argument is that he can win all the core Democrat votes Mr Kerry can and attract moderate votes that Mr Kerry cannot. In Wisconsin Mr Edwards won a plurality of independents. He won by a wide margin among self-identified Republicans and roughly tied with Mr Kerry among moderates. This challenges Mr Kerry's "electability"—the self-reinforcing view that he is best placed to beat Mr Bush because he wins the most primaries. In a new Gallup poll, Mr Edwards would beat George Bush by ten points, though admittedly Mr Kerry would do even better.

Mr Edwards also seems to grow on you. He won easily among those who made up their minds in the last three days, thanks partly to a good performance in an eve-of-polling debate and partly to the late endorsement of Wisconsin's largest newspaper, the *Milwaukee Journal Sentinel*. An unusually charismatic campaigner, Mr Edwards does best where voters have enough time to get to like him. Again, that would be an advantage in the long general election campaign.

On the face of it, it is a problem now. In the next big round of contests, on March 2nd, ten states vote at once: no time for Mr Edwards to weave his magic, especially in the two biggest states, California and New York, which are expensive to campaign in.

But the calendar is better than it looks. Mr Edwards will concentrate on the next biggest Super Tuesday states—Ohio and Georgia. They both use an "open primary" system like Wisconsin (ie, Republicans and independents can vote in the primary). If he can snatch one or two of these states, Mr Edwards would enter the next round of primaries on March 9th in good shape. They take place in Texas, Florida, Louisiana and Mississippi, all southern states where he should do well.

But before getting carried away, remember that Mr Kerry now has 610 delegates to Mr Edwards's 192—a margin that will be hard to overcome unless the front-runner implodes because of a mistake or a scandal (he has already survived one false accusation of having had an affair). Moreover, the Wisconsin result does not suggest his core strengths are eroding.

Mr Kerry won a whopping 48% of self-identified Democrats (to Mr Edwards's 31%). If Wisconsin had used Democrat-only rules, Mr Kerry would now be celebrating yet another landslide. He won convincingly among blacks, Latinos, self-identified liberals, voters angry or disappointed about the economy and those for whom the most important issues are health care, education, Iraq and taxes—all the usual Democratic suspects.

If Mr Edwards is to change these voters' minds, he will have to give them a reason, which almost certainly means establishing policy differences with Mr Kerry. At the moment, this is hard. With one exception, the two senators' domestic proposals—on tax cuts, education, health care and education—are similar. The exception is trade and, in Wisconsin, Mr Edwards used anti-NAFTA rhetoric to establish

differences with Mr Kerry. But these did not have the impact you might have expected.

Mr Edwards did well among those who think the economy is in good shape and among higher-income earners. Mr Kerry won among those who think the economy is bad and those on the lowest incomes. So Mr Edwards's decision to highlight trade differences weirdly helped him with those doing well—who could form a substantial block in the general election. But it did little to attract union members, populists or those to Mr Kerry's left—who are more important in the Democratic primary. This week, the umbrella trade union organisation, the AFL-CIO, was due to meet to endorse Mr Kerry.

In short, Mr Edwards has established himself as a serious rival and ensured the race will go on longer. It is less clear that he knows how to win it.

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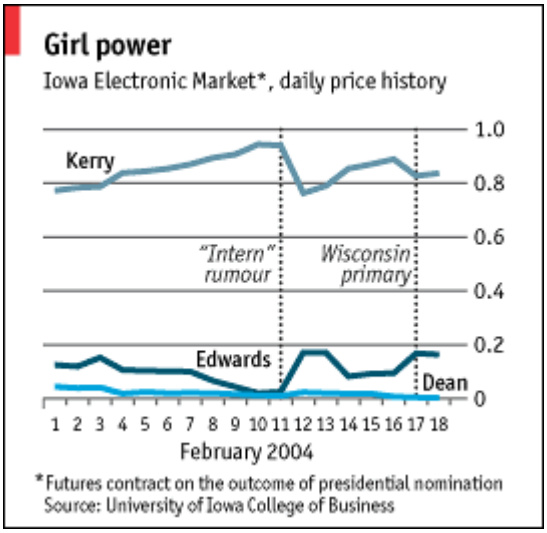
The electoral week

Primary colour

Feb 19th 2004
From The Economist print edition

Hold your horses



"Not so fast, John Kerry. We're going to have an election here in Wisconsin this Tuesday. And we've got a whole group of primaries coming up. And I, for one, intend to fight with everything I've got for every one of those votes."

John Edwards in the Wisconsin Democratic debate, February 15th

Pastoral moment of the week

"Clearly, he lied. Now if he is an unconscious liar, and doesn't realise when he's lying, then we're really in trouble...So I hope he knew he was lying, because if he didn't, and just went in some kind of crazy, psychological breakdown, then we are really in trouble...I'm a minister. Why do people lie? Because they're liars."

Al Sharpton at the debate on George Bush

Molar alert

"I can't understand any more hard evidence than having his teeth there."

Mr Bush's communications director on the release of dental records from the president's time in the Air National Guard, New York Times*, February 16th*

A Monica moment

"Well, there is nothing to report. So there is nothing to talk about. I'm not worried about it. No."

Mr Kerry responds to the much ballyhooed "intern rumour", later also strenuously denied by the woman named, "Imus in the Morning", MSNBC, February 13th

Spoiler alert

"Dean supporters are calling and e-mailing us, saying Kerry used dirty tricks on Dean, and urging Ralph to get into the race as payback."

A Ralph Nader staffer on why the erstwhile Green candidate might run again, Newsweek*, February 23rd*

Hanoi John

“We spoke at a rally once. I spoke, and then a lot of other people spoke and he spoke. I don't even think I shook his hand. So the attempt to smear him by trying to connect the two of us is a dirty, black propaganda tactic...”

Jane Fonda on a faked photograph showing her and Mr Kerry together at an anti-Vietnam war rally, “Paula Zahn Now”, CNN, February 11th

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Gay marriage

Out in front

Feb 19th 2004 | LOS ANGELES
From The Economist print edition

Reuters

The City by the Bay makes it legal—but for how long?

PROUD as it is to be the capital of gay America, San Francisco was slightly miffed when Massachusetts, after a ruling of its Supreme Court on February 4th, became the first state in the union to legalise same-sex marriage. But the Californian city soon resumed the lead.

On February 10th—more than two months before the Massachusetts ruling will take effect—Gavin Newsom, recently elected as San Francisco's Democratic mayor, ordered city officials to alter the marriage-licence form so that homosexual couples could be legally wed. Two days later, City Hall was issuing licences to a queue of homosexual pairs that stretched around the block. Within less than a week, more than 2,500 such couples were legally hitched until death or whatever, with the rain-dampened queue showing no signs of shortening.

But is San Francisco's “gay victory” permanent—let alone one that will spread to the rest of the nation? Already conservatives are fighting the measure hard both in the courts and in election politics.

The first two legal challenges to the city have been survived—but only just. On February 17th, two San Francisco judges rejected separate attempts to stop the weddings, largely on procedural grounds (one pointed out that the plaintiffs had wrongly used a semi-colon rather than a conjunction). One judge appeared to allow the city six more weeks of issuing licences; the other wants a hearing for February 20th.

The conservative challenges are based on an amendment to Californian family law, approved in 2000 by more than 60% of voters, which defines marriage as between a man and a woman. The Defence of Marriage Act, signed by President Bill Clinton in 1996, takes the same definition, and it was at the heart of a law that conservatives have just tried (and failed) to pass in Massachusetts. California's governor, Arnold Schwarzenegger, who hails from the tolerant wing of the Republican Party, has already urged Mr Newsom to obey state law and stop marrying people.

Mr Newsom's argument is that he has the state constitution on his side: it guarantees equality before the law. He reckons that today's fight for gay rights is no different from previous battles for civil rights, including, for example, the right for blacks to marry whites (not allowed until 1967 in some 18 states). This is something that the state Supreme Court will have to rule on—and, as with Massachusetts, San Francisco is also throwing up legal questions that may end up in the federal Supreme Court. For instance, what rights will a homosexual couple, married in San Francisco or, soon, Boston, enjoy in other states or

cities that do not recognise the procedure?

The political challenge is under way, too. For all the tolerance of homosexuals in the workplace, only a minority of Americans are willing to grant them the right to marry. That minority is much more likely to vote Democratic than Republican—which gives George Bush an issue that can rally the Christian right and taunt, if not torment, his Democratic rivals. After all, the only state to allow gays “civil union”, just a step short of legal marriage, is Vermont—where the measure was signed into law in 2000 by its then governor, Howard Dean. And let no one forget that Massachusetts is the home of Senator John Kerry.

All of which explains why most Democrats, Mr Newsom excepted, are trying to blur the issue, preferring to talk in terms of civil union rather than full-fledged marriage. Mr Kerry, for example, says he is against gay marriage, whatever the Massachusetts judges may think. Indeed, he says he agrees with Dick Cheney. That is a clever ploy since the vice-president, who has a lesbian daughter, said in 2000 that the question of rights for gay couples is best left to the states, adding that “different states are likely to come to different conclusions, and that's appropriate.”

Whether Mr Cheney still thinks it appropriate is another matter. Last month he said he would support whatever position the president decides to take—which could well now be a constitutional ban on gay marriage. For that is what many social conservatives are now demanding Mr Bush push through Congress.

Yet going from theory to practice could be difficult. Two-thirds majorities in both the House and the Senate are required to pass any constitutional amendment, and it must then be ratified by at least 38 of America's 50 states. Although some 38 states legally restrict marriage to opposite-sex couples, any ban on gay marriages might well have to be softened by a recognition of Vermont-style civil unions, which many moderate Republicans, including Mr Schwarzenegger, support.

Moreover, feelings for or against a constitutional ban do not run neatly along party lines. Although most Republicans, especially the party's evangelical Christian wing, are deeply opposed to homosexual marriage, they are also by tradition in favour of states' rights and against federal interference. Similarly, while upper-class Democrats may delight in a liberal view of gay rights, many of the party's black, elderly and working-class voters tend to disdain gays in general and the idea of gay marriage in particular.

The implication, therefore, is that gay marriage is a subject to be handled with care. The Democrats need to avoid being typecast as latter-day, dissolute hippies; the Republicans must beware of being seen as reactionary bigots. Meanwhile the gay world, too, is in disarray. Some homosexuals reckon that Mr Newsom has gone too far, and risks provoking a backlash; others think he has set in motion an overdue process to give them the legal rights enjoyed by opposite-sex married couples. For his part, Mr Newsom, the new hero of Castro Street, has no doubts: “There's no such thing as separate but equal.”

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California's debt

So you decide

Feb 19th 2004 | LOS ANGELES
From The Economist print edition

The new governor asks the voters to get to grips with it

Get article background

"I AM committed to putting our financial house in order," Arnold Schwarzenegger tells Californians, "and I need your help." He does indeed. If California's voters, trooping to the ballot on March 2nd to choose everyone from a presidential candidate to the local school board, reject Propositions 57 and 58, the governor's aura of invincibility will be blown away—and the problems of a state cursed with a huge debt and a gridlocked legislature will look as insoluble as ever.

Hence the current barrage of television ads, featuring not just the Republican governor but also (looking somewhat puny beside action-hero Arnold) Steve Westly, the state's Democratic chief financial officer. Proposition 57, the "Economic Recovery Bond Act", will authorise the state to borrow up to $15 billion to pay off its accumulated debt. Proposition 58, the "California Balanced Budget Act", will require the state to pass a balanced budget and set up a budget reserve, and will come into effect only if 57 is also approved. In the governor's pithy analysis, "Proposition 57 will refinance past deficit borrowing at low interest rates, and Proposition 58 tears up the credit card for good. It requires a balanced budget every year without borrowing, so we never get in this mess again."

Mr Schwarzenegger is stretching the truth a bit: the "past deficit borrowing" includes not just the $10.7 billion five-year bond authorised by the legislature last year (and now subject to legal challenge because it was not approved by the voters) but also the $4 billion or so which he decided to forgo when he cancelled an increase in vehicle-licensing fees. Moreover, interest rates on the proposed bond may well be lower, since the bond will be for a period of nine to 14 years, but the grand total of interest payments is likely to overtake the short-term savings.

Tom McClintock, a hard-line Republican state senator who opposes 57, calculates that "in addition to the $15 billion in principal, taxpayers will have to pay $6 billion more in interest—bringing the total cost to $21 billion or more than $2,000 for every family in California...More than 8% of our state general-fund spending will be for nothing more than debt service into the foreseeable future."

A great many Californians share at least some of Mr McClintock's doubts. In opinion polls taken last month, only 35% of "likely voters" said they would vote yes on 57. (Somewhat irrationally, since each proposition depends on the other being passed, 57% said they would vote for 58.) However, the "don't knows" for both propositions came to 21% of likely voters, and Mr Schwarzenegger has a proven ability to sway the public. He has also shown a rare ability to play politics, convincing not just big business but also all leading Democrats to support 57 and 58.

But do both sides of the political divide share a common interest in yet another budget-related initiative, Proposition 56? This would lower the majority in the legislature needed to pass budget and tax bills from the present two-thirds to 55%. And if the lawmakers failed to pass a budget on time, they would have to remain in session and they and the governor would lose all pay and expenses for each day's delay.

Since only two other states—Rhode Island and Arkansas—have a California-like "super-majority" for passing a budget, advocates of this proposal say the state would be joining the mainstream; its lawmakers would become more ready to compromise; and its public services would not have to suffer from delayed state spending. Opponents, notably in the tobacco, alcohol and oil industries, reckon that 56 would simply make it easier to raise taxes.

In a way, they are right. In a legislature where redistricting has given almost all lawmakers safe seats,

the tax-averse Republican minority would no longer be able to block the Democratic majority. Yet they may protest too much: a California governor has a line-item veto power that can be overridden only by a two-thirds vote. As the *Los Angeles Times* points out, Mr Schwarzenegger “would no doubt demonstrate how to use it liberally.”

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Lexington

Time for him to go?

Feb 19th 2004
From The Economist print edition

Why Dick Cheney should watch whom he travels with

Get article background

A YEAR ago, with the invasion of Iraq imminent, George Bush delighted guests at the American Enterprise Institute's annual dinner by unveiling his plans to democratise the Middle East. A year later, conservative Washington once again massed in the Washington Hilton ballroom to enjoy the AEI's hospitality and hear from the administration—this time from Dick Cheney.

You might have thought that the faithful would be feeling a little chastened by recent events. Not a bit of it. Mr Cheney looked as cocksure as ever. Charles Krauthammer treated the guests to an interminable celebration of American power. The chatter after dinner was surprisingly upbeat. Those missing weapons of mass destruction? Much ado about nothing. Of course, these conservatives were prepared to admit the odd setback—Mr Bush's flaccid state-of-the-union speech, for instance, or the fact that Howard Dean was no longer the likely Democratic nominee—but nobody seemed to be taking seriously the idea that John Kerry might actually be elected president in November. “This country won't elect a Massachusetts liberal,” declared one senior journalist flatly.

This sounds strangely like the pride that goes before a fall. Mr Bush certainly stands a good chance of hanging on to the White House—but not if he underestimates Mr Kerry as his father did his philandering southern rival. The Republicans had expected the first quarter of the year to be dominated by Democratic squabbling; instead, the pounding coming from American television screens has been that of relentless Bush-bashing. For all his liberal traits, Mr Kerry looks a formidable presidential candidate, and even if he slips up in the run-in he will be replaced by John Edwards—the southerner whom Mr Bush's people feared most at the beginning of the contest. If nothing else, the Democratic Party has shown that it is obsessed by the idea of getting Mr Bush out of the White House.

The Bush campaign needs a jolt, not just to wake up the ideologues at the AEI but also to improve the president's standing among independent voters. And what bigger jolt could he give it than to start at the top—or rather second from the top—with the vice-president? In 1992, Mr Bush tried to persuade his father to ditch Dan Quayle. The idea that Mr Cheney might also be a “drag on the ticket” was unthinkable a year ago. Now it has begun to seep into the more hard-headed, vote-scrounging parts of the Republican Party, and become common chatter among political operatives from both parties. It is,

indeed, the current cover story of the *National Journal*, the inside-the-Beltway bible.

This is partly Mr Cheney's own doing. Four years ago, he looked the perfect complement to young George, possessing everything the callow Texan lacked—gravitas, eloquence and experience. Nowadays, he is seen less as the sober pragmatist and more as the dangerously revolutionary zealot. Look at economic management, where he supposedly told Paul O'Neill, his former friend and the former treasury secretary, that “Reagan proved deficits don't matter.” Or look at Iraq, where the vice-president went further than anybody else in exaggerating Saddam's “reconstituted” nuclear-weapons programme and the idea that he provided a “geographic base” for terrorism against America.

Another reason to ditch Mr Cheney is that he has come to epitomise the administration's darker side. Take corporate cronyism. The vice-president made $44m during his time as head of Halliburton, a company that has snaffled up a large number of lucrative contracts in Iraq and has been accused of overcharging the Pentagon into the bargain (see article). He also stuffed his energy task-force with friends from the energy industry. Or take bureaucratic secrecy: he has created a semi-official parallel administration within the White House and has fought like a tiger to keep his doings private. His recent decision (just after the Supreme Court had said it would review whether he could continue to keep secret the deliberations of his energy task-force) to use a government jet to take Justice Antonin Scalia and a bunch of Mr Cheney's oil-business buddies duck-shooting only reinforces the impression that he has a tin ear for politics.

There are also positive reasons for dumping Mr Cheney. Bringing in a fresh face as vice-president would suggest that the second Bush term will be more than just a re-run of the first. It would also allow Mr Bush to add someone to the ticket who has a better chance of attracting swing voters than a retired CEO from a solid Republican state.

The case for Bill Owens

Who might that be? Rudy Giuliani might burnish Mr Bush's reputation for fighting terrorism, though he is not known for his ability to play second fiddle. Condoleezza Rice might do something to neutralise the Democrats' traditional advantage among blacks and women. But some Republicans would rather turn to Bill Owens, the governor of Colorado. There are signs that Mr Kerry is planning to write off the South in order to concentrate on loosening the Republicans' hold on the south-west. What better way to check this threat than to add the Republican Party's brightest western star to the ticket?

It hardly needs saying that replacing Mr Cheney would have to be done with the utmost finesse. Otherwise, it might seem that the Bush White House was falling apart. Mr Cheney would have to retire gracefully, blaming his dodgy heart (he has already had four heart attacks) and no doubt accepting a post as senior counsellor from a grief-stricken president. Persuading such a powerful vice-president to step aside will be no easy thing, of course. But the Bushes don't have a reputation as the Corleone family of the Republican Party for nothing. The next time Mr Cheney takes that jet to go duck-shooting, he may well find James Baker slipping into the seat behind him, with “a litl' proposal to discuss for the good of the party”.

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Correction: Fort Bragg

Feb 19th 2004
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Last week, in our piece on troop rotation ("Fearing Fort Bragg") we inadvertently rotated Fort Bragg to South Carolina. It is still in North Carolina.

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Indigenous people in South America

A political awakening

Feb 19th 2004 | COTACACHI, LA PAZ AND LIMA
From The Economist print edition

Reuters

Poverty and a new ethnic politics have spawned radical Indian movements in the Andean countries. Are these a threat or a boost to democracy?

LUCIO GUARACHI was born in a village on Bolivia's windswept Altiplano, some 4,000 metres (13,000 feet) above sea level. Of Andean Indian descent, he speaks Aymara as well as Spanish. Since he was ten, he has lived mainly in El Alto, an ever-expanding satellite city of 700,000 people whose self-built houses of bare brick or mud and corrugated iron straggle out into the Altiplano above Bolivia's capital, La Paz. He works, when there is work, in a small workshop making water pumps. Last October, he helped to overthrow an elected president.

El Alto was the scene of battles between the army and well-organised protestors that ended with at least 59 dead and the resignation of President Gonzalo Sánchez de Lozada, a pro-American mining magnate. The ostensible motive for the protests was a scheme by multinational companies to export liquefied natural gas from Bolivia to California via Chile.

But was there another factor at work? Most of the protesters were of indigenous descent. The trigger for their action lay in an obscure incident in Pucarani, a small town near Lake Titicaca. Indian followers of Felipe Quispe, a militant peasant leader, had captured two cattle rustlers; invoking indigenous traditions of justice, they beat and killed them. When police arrested his lieutenant for the crime, Mr Quispe organised roadblocks. After protestors and police were killed, matters escalated.

Many observers saw the El Alto uprising as an example of a new ethnic politics in Latin America, a flexing of political muscles by Indian peoples long subordinate to the dominant “white” elite. Though recession, poverty, America's “war” on drugs, and century-old hostility to Chile played big parts too, the emergence of newly assertive Indian movements in the Andean countries is undeniable. As well as threatening political stability, they help to explain growing support for far-left leaders, such as Mr Quispe and Evo Morales, an Aymara Indian who is the leader of Bolivia's coca growers (whose crop provides the raw material for cocaine).

It was not the first time that Indian protestors have helped to topple a democratic president. In Ecuador in January 2000 tens of thousands of Indians, allied with dissident army officers, forced the resignation of

Jamil Mahuad. Three years earlier, Indians had helped to oust Mr Mahuad's predecessor but one, Abdalá Bucaram.

It may not be the last, either. In Bolivia, Carlos Mesa, the former vice-president, has taken over the top job. But Bolivian democracy remains fragile. In Ecuador in 2002, the Indian movement helped to elect Lucio Gutiérrez, one of the dissident army colonels. Now it feels betrayed: he has accepted a loan from the IMF and is friendly to the United States.

Indian leaders blame the government (it denies it) for a recent attempt on the life of Leonidas Iza, the president of the Confederation of Indigenous Nationalities of Ecuador (CONAIE), the country's main Indian organisation. Outraged, CONAIE this week launched roadblocks and protests aimed at forcing the president to resign. But the movement has been weakened by splits between radicals and pragmatists; after two days, most of the protests were called off.

This political awakening of Latin America's indigenous people is not confined to the Andes. “Marcos”, the balaclava-clad leader of Mexico's Zapatista movement, is a middle-class white but he has drawn on the grievances of Mayan Indians. In Brazil, Indian peoples fight for land against encroaching agribusiness.

After the Incas

But it is in the Andes that Indian militancy seems most threatening to democracy and economic development. Compared to Brazil or Mexico, Indians make up a far larger proportion of the population in the countries of the former Inca Empire, as they do in Guatemala (see map). The Andean democracies are fragile for many other reasons: they are relatively poor, and their states are corroded by the drug trade. Colombia remains embroiled in violent conflict. In Peru, coca growers plan protests this month which, according to the interior minister, could involve an attempt to overthrow the democratic—but deeply unpopular—president, Alejandro Toledo, who is himself of Andean Indian descent.

Venezuela's populist president, Hugo Chávez, is itching to export his “Bolivarian revolution” to his neighbours. His chosen instrument is the Bolivarian Congress of the Peoples, a putative pan-Latin American revolutionary movement, to which Indian-led parties in both Ecuador and Bolivia belong. Many of the Indian leaders do not hide their admiration for Mr Chávez and for his friend and mentor, Cuba's Communist president, Fidel Castro.

A just cause

Behind all this agitation lies a just cause and a bitter history dating from the Spanish conquest. Robbed of their best lands, subjected to forced labour and heavy taxation as well as European diseases, the Indian population of the Americas shrank to around 10% of its pre-conquest level. It has since grown. But independence did little to alter the Indians' second-class status, or the racism they suffered.

In the 20th century, paternalistic efforts were made in several countries to improve the lot of indigenous people, and their cultural legacy was recognised. The aim was assimilation. Indian peoples, it was tacitly thought, would disappear under the twin processes of *mestizaje* (racial mixing) and urbanisation.

They did not. According to the best estimates, there are some 45m indigenous people in Latin America today. Who are they? Those who define themselves thus, say social scientists. That self-definition does not turn on language and dress, nor still less on living in a rural community (though all those elements may be important to Indian cultural identities).

The rise of the new Indian movements has several causes. First and foremost, most indigenous Latin Americans still live in poverty, and many in extreme poverty. Compared with the rest of the population, they have fewer years of schooling and are less likely to enjoy basic services, according to the World Bank. While access to primary schooling is now nearly universal, that is not true of higher education. Whereas 18% of Ecuadoreans aged between 18 and 25 are in full-time education, the figure for indigenous Ecuadoreans is only 1%, reckons Fernando García, an anthropologist at FLACSO, a postgraduate school in Quito.

Indians also continue to suffer discrimination, and worse. In Guatemala, Mayan Indians made up most of around 180,000 people killed by the army in suppressing leftist guerrillas in the 1970s and 1980s. In Peru during the “dirty war” unleashed by the Shining Path guerrillas in the 1980s and early 1990s, Indians suffered disproportionately: 75% of the 60,000 victims spoke Quechua, and an Amazonian tribe, the Ashaninka, suffered “near genocide” according to Carlos Ivan Degregori, an anthropologist who served on the recent “Truth Commission” which investigated these events.

Two other factors explain the new movements. The first is democracy. New constitutions in Ecuador and Peru granted illiterates the vote for the first time (in Bolivia, this had been achieved after a revolution in 1952). The second is globalisation. Indian groups began to receive support from the Catholic Church and rich-world charities in the 1970s. They are linked to a wider international network. This was given a boost in Latin America by the protests over the commemoration in 1992 of the quincentenary of Columbus's “discovery” of the Americas.

The Indian cause was given legal force by Convention 169 of the International Labour Organisation. This committed signatory governments (and most in Latin America did sign) to guarantee indigenous people equal rights; participation in formulating policies that affect them; respect for their institutions, customary law and culture; and health and education.

Democracy and the quest for indigenous rights have taken the Indian movements into the political arena. That is long overdue: indigenous people lacked representation. In Ecuador, CONAIE set up a mainly Indian political party called Pachakutik (“reawakening” in Quechua, but also the name of the greatest of the Incas). It currently holds 19 out of 215 municipalities, five provincial governorships (out of 22) and ten of the 100 seats in Congress.

Something similar has happened in Bolivia. In a general election in 2002, Mr Morales's (mainly Indian) Movement to Socialism won 21% of the vote and Mr Quispe's party, also called Pachakutik, won 6%. Between them, they captured 33 seats in Congress's lower house. Including those from traditional parties, in all some 50 of the 130 deputies are indigenous.

In Peru, *mestizaje* has gone much further than in Bolivia. There, rural Indians have tended to define themselves as *campesinos* (country people). Peru's urban Indians, known as *cholos*, many of them working in the informal economy as small businessmen or employees, are having a decisive impact on politics and culture. Though there are no significant Indian parties, Indians are winning office. Mr Degregori cites research in Ayacucho department: in ten municipalities studied, only one had a Quechua-speaking mayor in 1966; 30 years later, all ten mayors spoke Quechua, six had a Quechua surname and seven had peasant origins.

Along with (or ahead of) political representation has gone a drive for legal reforms. In a round of constitution-writing in Latin America in the 1990s, the ILO's provisions were incorporated in ten countries, including Bolivia, Colombia, Ecuador and Peru. For the first time these constitutions declared their countries to be “pluri-ethnic” and/or multicultural.

Quechua lessons

Between them, democracy and constitutional reform have provided the Indian movements with a new political agenda. One priority is laws to implement the constitutional proclamation of collective rights. Another is local self-government.

To see this at work, visit Cotacachi, a small town in a verdant valley between two lowering volcanoes, a couple of hours' drive north of Quito. The school at Tunibamba Llacta, a hamlet near Cotacachi, consists of two huts next to a football pitch carved out of a mountainside and scuffed bare of grass. The school is surrounded by maize fields and small, red-tiled farmhouses. There are just two teachers for the 75 pupils.

One of them is José Menacho, a young Indian whose long black hair is pulled back from his handsome copper-coloured face into a pigtail. On the board, he draws a dog. “Allku”, he repeats to his class of five-to-eight-year-olds, some of whom are paying attention. He then draws a sun (“inti”, he writes) and a hot pepper (“uchu”).

Mr Menacho is teaching reading and writing in Quechua, his pupils' first language. Bilingual education in primary schools began in Ecuador in 1988. Educationalists thought it would improve the performance of indigenous children; activists hoped it would preserve the language. But the scheme suffers from a lack of teachers and materials.

Cotacachi, with 37,000 people, has been governed since 1996 by Pachakutik. The mayor, Auki Tituaña, a thoughtful economist, is trying hard to make bilingual education work. A pilot project to improve rural schools, involving parents and $128,000 from the education ministry, operates from Tunibamba Llacta. Back in the town, a dozen teachers and education officials from across the country are meeting to draw up a history text book in Quechua for older children.

Mr Tituaña has also launched “participatory budgeting”, an idea copied from Brazil's left-wing Workers' Party. In the past, nearly all the public money was spent on the main town of Santa Ana de Cotacachi, whose 7,000 people are 90% *mestizo* (mixed race). Now, it is spread around the district. A crackdown on corruption and mis-spending means the town has not lost out, Mr Tituaña says. Each year, he reports back to a three-day communal assembly. It all seems to work: Mr Tituaña was re-elected in 2000 with 80% of the vote (including that of many *mestizos*).

Democracy or extremism

Such experiences show that the Indian movements can bring about a welcome deepening of democracy. But there are several big dangers. One is extremism. To those in Washington who try to link him with drug traffickers or Colombian guerrillas, Mr Morales retorts that he is a democrat: “Here we have decided to reach power by means of the vote, not by arms nor by insurrectional means,” he says. His party has decided to concentrate this year on municipal elections in December.

But Mr Morales remains an incipient democrat. Mr Quispe, who has a guerrilla past, is not even that. “We have to be prepared for violence,” he says. Neither is the behaviour of the Indian movements always democratic. “Participatory democracy” can mean greater accountability—or rule by mass-meeting or mob. Taking to the streets is essential under dictatorships but, in excess, can weaken democracy.

A second danger is anti-capitalism. Beyond their tired rhetorical opposition to privatisation and the IMF, the Indian parties are also hostile to multinational firms, and especially to foreign investment in oil, gas and mining projects. That is placing a brake on economic growth in Bolivia, Ecuador and Peru. In a few cases, that Indian resistance reflects justified environmental concerns. But is there a deeper tension between indigenous cultures and entrepreneurship? Mr Iza of CONAIE argues that collectivism is a central part of indigenous culture, and has allowed its survival against the odds. However, Indians have no difficulty operating in the market economy when given the chance—as markets across the Andes testify.

A third danger lies in racial politics. Mr Quispe says he wants an independent Indian republic called Kollasuyu, after a segment of the Inca empire: “We want to have our own army, flag, constitution and education.” In Peru, Antauro Humala, a *mestizo* former army officer, has organised ex-conscripts into an anti-democratic “Inca nationalist” movement.

Few others go as far. But in the call for territorial autonomy and collective rights there is a potential conflict with democracy. Proponents, such as Rodolfo Stavenhagen, a Mexican sociologist, argue that systematic discrimination vitiates the enjoyment of liberal freedoms.

> Something more is needed...a bundle of group rights allowing the indigenous...to reproduce their cultures, organise their lives according to their own social norms, maintain and develop their own collective identities, enjoy social, political and legal status as distinct groups in the wider society and relate to...the state on their own terms as recognised and respected peoples or nations.

No state in Latin America has been prepared to concede all of that, and for good reasons. Many of the norms appealed to are authoritarian ones, dating from colonial custom as much as the Incas or Aztecs. Collective rights can be inimical to human rights, as the murders in Pucarani showed. Ceding authority for law and order risks creating “power vacuums” says an adviser to Peru's interior minister. He cites cases where *ronderos* (communal vigilantes) have expelled mining engineers.

But a reasonable compromise is possible and desirable. A mix of decentralisation plus pragmatic recognition of traditional customs and authorities can go a long way to satisfy Indian demands without undermining the authority of the state. Peru's government is searching for a consensus that would allow *ronderos* to sanction minor offences in unpoliced rural areas, subject to judicial oversight.

Wider horizons

Another reason for hesitation is that indigenous cultures, like all cultures, are evolving. Activists admit that parents were resistant to their children being taught in Quechua. In Cotacachi, at parents' request, children are also taught rudimentary English, so that they can sell handicrafts to tourists. Urbanisation has brought big changes and, for some, wider horizons.

Take, for example, Felipe Copaja, the owner of the workshop in El Alto where Mr Guarachi works. He, too, was born in an Indian village and speaks Aymara as well as Spanish. But he has prospered. On his wall hangs a certificate showing that his business is legally registered and that he pays taxes. His daughter has just begun studying medicine, and his son hopes to follow her to university.

Mr Copaja says that there is less discrimination than in the past. In Ecuador, Mr Tituaña agrees. Now aged 39, he remembers that as a child his mother would drag him into the street to let a *mestizo* pass on the pavement. When Indians came down from the hills to market, town officials would confiscate their ponchos and hats to force them to clean the streets without pay. “The *mestizo* has begun to see us with greater respect, but they still don't see us as equal partners,” he says.

Racial mixing meant that Latin American countries have never adopted anti-discrimination laws. Such laws would confirm, more effectively than a panoply of group rights, that Latin America's indigenous peoples are full and equal citizens of its democracy. If Indian movements are tempted by extremism, that is partly because for too long democrats among the traditional political elite have been complacent in the face of prejudice.

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Canada's government

A timebomb hits Martin

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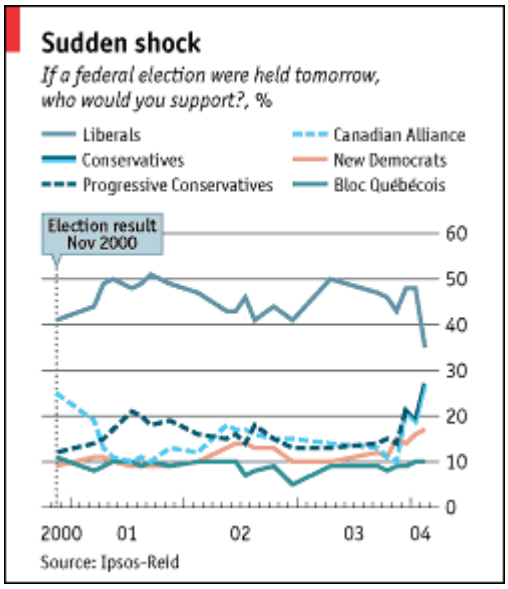
From The Economist print edition

Sleaze changes the electoral calculations

Get article background

ONE of Paul Martin's first moves on taking over as prime minister in December was to kill off a scandal-plagued publicity drive launched by his predecessor, Jean Chrétien, to bolster the cause of Canadian unity in French-speaking Quebec. The message Mr Martin hoped to send was that even though the Liberals have been in power for more than a decade, under his leadership they are making a fresh start.

No such luck. An excoriating report by the independent auditor-general released this month says the publicity programme was abused to funnel C$100m ($75m) of public money to Liberal cronies. Canadians got little in return. Their anger over the affair has wounded Mr Martin's fledgling government. Only last month the prime minister was seen as certain to call a spring election with the expectation of romping to an easy victory. Now, the polls suggest the Liberals would be lucky to hang on as a minority government (see chart). A spring election suddenly looks less likely.



The roots of the scandal go back to a 1995 referendum in Quebec, in which the province came within a whisker of seceding. To prevent a repeat, Mr Chrétien launched the C$250m campaign to promote federalism at sporting and cultural events. This turned into a slush fund: much of the money went to friendly advertising firms and back to government agencies—minus a hefty commission. The auditor found faked invoices, double-billing, and extravagant payments without tenders or contracts. One firm was paid C$550,000 for a report no one has ever seen.

Most of this was already known—journalists began exposing the story two years ago. But the auditor's report added details and underlined the scale of the scam. It was an “outrageous” and “appalling” scheme “designed to put money” into the Liberal-linked advertising firms, she said.

Nothing to do with me, has in effect been Mr Martin's largely sure-footed response. He ordered an independent inquiry and promised to testify before it. He asked a special counsel to find out exactly where the missing millions went (to pay the Liberals' campaign debts, say some). He fired Canada's ambassador to Denmark, Alfonso Gagliano, who as Mr Chrétien's public-works minister was closest to the scandal.

In daily press conferences and on talkshows, Mr Martin repeated that although he was finance minister when most of the cheques were written, his job involved economic policy, not the minutiae of spending. True enough—but many Canadians are disinclined to accept this.

Already one Liberal backbencher has quit the party. Ironically, Canadian unity, the ostensible object of the original exercise, could also be damaged. English Canada sees the scandal as an example of Quebec's traditionally grubby politics. In the province, the secessionist Bloc Québécois leads the opinion polls after being written off for dead two months ago.

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From bad to worse

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Rebels opposed to President Jean-Bertrand Aristide seized more Haitian towns this week. They were reinforced by two exiled figures from Haiti's brutish past: Louis Jodel Chamblain (pictured), an enforcer for a dictatorship which ousted Mr Aristide in the early 1990s, and Guy Philippe, whom the government links to a coup attempt in 2001. The American government is worried about a refugee exodus, but has little appetite for stepping in. France is keener. Dominique de Villepin, the foreign minister, set up a “crisis group” to assess whether to send a “buffer force”.

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Brazil's party-finance scandal

A halo tarnished

Feb 19th 2004 | SÃO PAULO
From The Economist print edition

Sleaze and the Workers' Party

Get article background

THERE is nothing new about Brazilian officials being caught on tape behaving badly. But when the official is the top aide of Jose Dirceu, the president's chief of staff, and the president is the saintly Luiz Inácio Lula da Silva, Brazilians take notice. Such was the case when *Época*, a magazine, published portions of a videotape from 2002 showing Waldomiro Diniz, then head of Rio de Janeiro's lottery, soliciting campaign contributions from a reputed boss of Brazil's illegal numbers racket (known as *jogo de bicho*).

The government has tried to cauterise the wound. Mr Diniz was summarily sacked from his powerful job as Mr Dirceu's link with Congress. The federal police were told to investigate. Mr Dirceu pointed out that the graft took place before Lula's Workers' Party (PT) took office in January 2003. But further revelations could fatally damage Mr Dirceu. At the very least, the PT, which always pounces on charges of wrongdoing by its rivals, will suffer acute and lasting embarrassment.

The system of party finance invites scandal. Brazilian candidates depend on large corporate contributions, notes David Samuels, a Brazil specialist at the University of Minnesota. The PT, erstwhile scourge of business, has had less to spend than its rivals because of its dearth of corporate funding. As it has grown into a national force, says Mr Samuels, the PT “may have had to bend the legal guidelines” as other parties have done.

Mr Diniz was breaking them in offering to let “Carlinhos Cachoeira” (Charlie Waterfall) influence a tender for a lottery contract in exchange for contributions (to PT candidates in Rio de Janeiro and Brasília) plus a payoff for himself. This risks becoming a pattern: the PT in Rio Grande do Sul, a southern state, was investigated in 2001 for ties with the *jogo de bicho*.

Some opposition congressmen want a parliamentary inquiry, which would paralyse Congress and might oblige Mr Dirceu to step aside for the duration. Brazil's financial markets, already hit by the scandal, would fall further. But most have little stomach for an inquiry that could end up scrutinising their own parties too. Instead, the affair will become a “political business opportunity” to win pork, predicts Murillo de Aragão of Arko Advice, a consultancy. Mr da Silva probably has more to fear from a still-jobless economic recovery. But his halo has been knocked askew.

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Corruption in South-East Asia

Who will watch the watchdogs?

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From The Economist print edition

Despite a few encouraging signs, South-East Asia's record on fighting corruption at the top is still mostly lamentable

MALAYSIA is agog with speculation. The government, which charged a sitting minister and a prominent businessman with corruption earlier this month, says it has a list of 18 other high-profile suspects due for similar treatment. Opposition politicians say that Rafidah Aziz, the minister of trade, should be among them. She denies any wrong-doing and says she will sue her critics for defamation—a threat they claim to welcome as a chance to prove their accusations in court. Is the pervasiveness of corruption, a problem common to most countries in South-East Asia, at last getting a proper airing?

The region is certainly awash with celebrated corruption cases. Joseph Estrada, the deposed president of the Philippines, is currently on trial for “economic plunder”. On February 12th, Indonesia's supreme court finally ruled on a long-running embezzlement case against Akbar Tandjung, the speaker of parliament. In 2001, Thailand's constitutional court heard charges that Thaksin Shinawatra, the prime minister, had concealed some assets during an earlier stint as minister. Last October, it sentenced a former health minister, Rakkiat Sukthana, to 15 years in jail for colluding with pharmaceutical firms.

But there is less to this flurry of righteousness than meets the eye. For starters, prosecutors have not had much success against grand defendants like Messrs Thaksin and Tandjung. Both persuaded higher courts to overturn earlier rulings against them. Mr Estrada, too, managed to evade impeachment while in office, and prosecutors are making heavy weather of their current case against him. Even the convicted Mr Rakkiat has not yet begun his prison term, since he jumped bail and went into hiding. What is more, all the countries in the region save Singapore and Malaysia still rank in the bottom half of the most recent “Corruption Perceptions Index” compiled by Transparency International, an anti-graft watchdog. Vietnam ranked 100 out of 133 countries, Indonesia 122 and Myanmar a dismal 129.

This poor showing stems in part from a lack of laws, personnel and money to combat corruption. But the resource in shortest supply is political will to tackle the problem. All countries in South-East Asia have at least one anti-corruption agency. But the ones that work best, argues Jon Quah, a professor at the National University of Singapore, are centralised, independent agencies such as Thailand's National Counter Corruption Commission. By contrast, Malaysia's Anti-Corruption Agency reports to the government, and so is subject to political control. The Philippines, meanwhile, has adopted no fewer than seven anti-corruption laws in the past 50 years, and created 13 anti-graft agencies, according to Mr Quah's count. Dramatic but disputed corruption allegations, such as the claim that the president's

husband is managing multiple slush finds, simply get lost in all this bureaucracy.

Even theoretically independent agencies, of course, are still subject to political interference, most obviously through appointments. The governing coalition in Thailand has learned how to maximise its say on the panels that select members of the country's various watchdog agencies—which have become much less meddlesome as a result. Indonesia's parliament, which just set up a similar agency called the Corruption Eradication Commission, declined to appoint the most crusading candidates as commissioners.

The courts can also undermine counter-corruption efforts. In the Philippines, cases can be drawn out for so long, through so many appeals, that the risk of prosecution does not provide an effective deterrent to corruption. In Indonesia, all courts are for sale, according to one supreme-court justice. At any rate, they often return quixotic rulings. The supreme court, for example, accepted Mr Tandjung's argument that he should not be punished for misappropriating funds as a minister, since he apparently did so on the orders of the president of the day, his administrative superior. At the very least, argues Harkristuti Harkrisnowo, a law professor at the University of Indonesia, the court should have considered Mr Tandjung an accessory to corruption. Instead, she worries, the new precedent paves the way for the court to dismiss several other pending corruption cases. And only a handful of cases have made it to court at all, despite Indonesia's many multi-million dollar corruption scandals in recent years.

That is where political will comes in. Indonesian politicians often speak of the need to combat corruption, but dragged their feet over the creation of the Corruption Eradication Commission. Members of parliament freely admit that they are on the take, so were naturally reluctant to put themselves under scrutiny. Gloria Arroyo, the president of the Philippines, also pays lip-service to anti-graft efforts. But when corrupt tax collectors rebelled against a reforming new boss last year, she backed down and accepted his resignation. In Thailand, Mr Thaksin implied during his own corruption trial that scrutiny of ministers was an unwarranted intrusion into the workings of government. Since becoming prime minister, he has stacked his cabinet with former businessmen, yet has not instituted any formal system to prevent them taking decisions that might affect their families' firms.

The counter-corruption mechanisms in Malaysia have not changed at all since Abdullah Badawi became prime minister last year. Yet instead of prosecuting a whistle-blower for releasing details of corruption investigations, as his predecessor did, Mr Badawi has hauled a minister into court. True, an election is imminent, and the minister in question is scarcely a heavyweight. But Mr Badawi is also taking serious steps to reduce corruption in the long term, such as awarding government contracts by open tender. If Malaysia had only instituted such a policy a decade ago, there might not have been any secret list of suspects to argue about.

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Indonesia

A long hot summer

Feb 19th 2004 | JAKARTA
From The Economist print edition

And an interminable election

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AP

Tandjung lives to fight another day

THOSE who find America's primary season protracted should spare a thought for the presidential candidates of Indonesia's Golkar party. They have been campaigning since last July for a nomination that will not be awarded until late April. A complicated system of provincial nominations and caucuses narrowed the field from 35 candidates to 19 in August, and then to seven in October. Now, in the middle of this drawn-out timetable, the supreme court has turned the contest upside-down, by quashing a corruption conviction against Akbar Tandjung, the leader of the party and one of the seven remaining candidates for its nomination.

The upheavals in Golkar, in turn, are altering calculations about the presidential election as a whole. What with a new election system, unreliable polls and weak party loyalties, the race to lead the world's biggest Muslim country is looking more unpredictable than ever.

Conventional wisdom has it that Mr Tandjung's acquittal favours Megawati Sukarnoputri, the incumbent president and candidate of the PDI-P party. When Mr Tandjung was still mired in legal difficulties, General Wiranto, a former army chief, had emerged as Golkar's probable nominee. Like Miss Megawati, General Wiranto is from Java, the island that accounts for some 55% of the electorate. Unlike Miss Megawati, however, he is thought to be firm and decisive. But as party leader, Mr Tandjung has the most influence over the delegates who will select Golkar's nominee. So now that the courts have let him off the hook, he has become the front-runner for the nomination, despite the air of impropriety that still hangs over him, and although he is not Javanese. Miss Megawati, the theory runs, would rather face Mr Tandjung than the redoubtable general.

The problem is that no one has any idea how the voters will behave. This is Indonesia's first direct presidential election. In the past, voters elected MPs, who in turn elected the president. This time, they will elect a new parliament first, on April 5th, and then a president, on July 5th. Most polls show Miss Megawati leading the presidential race, but only by a few percentage points, and with huge numbers of voters still undecided. The electorate as a whole has never before had a chance to choose between Javanese and non-Javanese candidates, or military men and civilians. Even association with Suharto, Indonesia's authoritarian former president, is not necessarily a minus, since many Indonesians now seem to hanker after the stability of his regime.

In previous parliamentary elections, voters have favoured nationalists over Islamists, broadly speaking. But the same may not apply to a presidential race, and there will probably be more than one candidate from each camp. Golkar and PDI-P compete for nationalist votes, while there are three big Islamic parties. In theory, multiple parties can band together behind a single presidential candidate. But if, as seems likely, Golkar wins the most seats in parliament, it will doubtless resolve to field a candidate of its own, while Miss Megawati, as the incumbent and the most popular individual in the race, is unlikely to step aside. The leaders of the Islamic parties are equally egotistical, so there could be any number of contenders from their ranks. Independent candidates are also waiting in the wings. Susilo Bambang Yudhoyono, another general, might appeal to nationalists yearning for a strong leader, while Nurcholish Madjid, a Muslim scholar, is widely respected.

To make matters even more complicated, the top two candidates go on to a run-off if no one wins more than 50% of the vote in the first round, an outcome that looks entirely plausible. That would stretch the elections out until September 20th—a long time indeed in politics.

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India and Pakistan

Talking it over

Feb 19th 2004 | ISLAMABAD
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The nuclear neighbours rattle tea-cups instead of sabres

NO ONE could accuse the statement issued by senior diplomats from India and Pakistan on February 18th of being riveting. It was full of the jargon of “technical-level meetings”, “expert-level talks” and “composite dialogue”. But when you have been to the brink of war, there is a lot to be said for diplomatic routine. In the humdrum lies the breakthrough.

EPA

Jaw-jaw in Islamabad: better than the alternative

The statement, which followed three days of talks in Islamabad, was a rough schedule for a series of bilateral meetings between officials, leading up to one between the two foreign ministers in August. Fulfilling a promise made by India's prime minister, Atal Behari Vajpayee, and Pakistan's president and army chief, Pervez Musharraf, when they met in January, the talks will cover all the disputes between the two countries, including the bitterest of them all—Kashmir.

Riaz Khokar, Pakistan's most senior diplomat, said there was “a realisation on both sides that war is not an option”. After three wars since independence in 1947, the testing of nuclear bombs in 1998, a bloody conflict in Kashmir in 1999, and the massing of a million troops along the shared border in 2002, that realisation, if genuine, changes everything.

Cynics point out that, in fact, India and Pakistan have been here before. The “composite dialogue” is largely a revival of a process tried and abandoned six years ago, and so far little has been achieved apart from a synchronisation of personal organisers. But the atmosphere is better than anyone can remember. An agreement to hold talks on nuclear confidence-building measures is especially heartening.

The two countries used never to miss a chance to discomfit each other. Yet India has refrained from making political capital from the recent revelations of Pakistan's involvement in spreading nuclear technology to Iran, Libya and North Korea. It also helped that, just before this week's talks, India confirmed that its cricket team would come to Pakistan in March. The tour was under threat because of worries about the players' safety (or even their performance, given the effects of a bad result on India's imminent elections).

India has also stopped harping on its demand that Pakistan dismantle the camps from which Pakistanis and others have been launched into Indian-administered Kashmir to join the long insurgency there. Pakistan, for its part, did not raise India's much-resented construction of a fence along part of the disputed “line of control” that divides Kashmir. Nor has India's continued hunting down of militants in

Kashmir interrupted the nascent peace process. Pakistan television, however, continues to broadcast harrowing propaganda on alleged Indian repression in Kashmir. Mr Khokar said it would be “helpful” if human-rights violations of this kind stopped.

Many Pakistani analysts suspect India of wanting to string Pakistan along, discussing relatively minor disputes, and making progress on improving transport, economic, cultural and other links, while refusing to engage on the core issue of Kashmir. They may well be right. But it may also be true that Pakistan will ultimately be ready to yield far more on Kashmir than it is suggesting in public. As Tanvir Ahmed Khan, one of Mr Khokar's predecessors as top official in the foreign ministry, puts it, “there is a grudging recognition that some of the myths that Pakistan has lived by are no longer tenable”. Even the army may have decided that the costs of backing the insurgency in Kashmir now outweigh the probable benefits.

Pakistani diplomats were privately amazed at how easily the talks had gone. The process is new-born and fragile and has yet to begin the real business of negotiation. But the two countries are glimpsing the remote possibility of a lasting peace. If the goal is that exciting, who cares if the journey is boring?

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Taiwan

Riling China, and America too

Feb 19th 2004 | TAIPEI AND BEIJING
From The Economist print edition

An election with some extra questions

Get article background

TAIWAN'S President Chen Shui-bian rarely misses an opportunity to have a dig at China. In the island's first ever televised debate between presidential candidates, he noted that the event was also a first for a "Chinese society". But leaders in Beijing have greater worries than jibes about their aversion to cameras. In their view a victory for Mr Chen in next month's polls could embolden him to make a push for formal independence.

Opinion polls published after the two-hour television encounter between Mr Chen and his opponent, Lien Chan, suggest that the public saw the feisty president as the better performer. But recent polls also show that support for the two men is almost equal, with the stolid Mr Lien perhaps even a whisker in front. Mr Lien's party, the Nationalist Party or Kuomintang (KMT), which appeared in danger of disintegration after it lost power in 2000 to Mr Chen of the Democratic Progressive Party (DPP) and its majority in the legislature in 2001, is still a force to be reckoned with, notwithstanding the president's efforts to portray it as corrupt and in league with China's Communist Party.

This is one reason why Mr Chen is so eager to chalk up another first for democracy in Chinese society by staging a referendum on the same day as the election, March 20th. The referendum will ask whether Taiwan should boost its missile defences in response to China's missile build-up on the coast facing the island, and whether Taiwan should enter peace talks with the mainland. The referendum has infuriated China, which sees it as a precedent for a vote on independence. But an angry China is just what Mr Chen wants in order to shore up the support of the independence-inclined DPP membership.

It is a gamble. In the course of riling China, Mr Chen has also unnerved Taiwan's supporters, particularly America. China has astutely avoided overt sabre-rattling, preferring instead to try to persuade America to apply the pressure. President Bush's obvious displeasure with the idea led to the adoption last month of a more mildly worded referendum than Mr Chen had originally envisaged. The KMT has denounced the whole exercise as illegal and wants voters to shun it. Tim Ting of Gallup Market Research Corp, Taiwan, says it is quite possible that fewer than 50% of the electorate will vote in the referendum, which would make it invalid. This would be highly embarrassing for the DPP, which wants another—and in China's view far more provocative—referendum in 2006 on a new constitution.

Cross-strait ties will be a crucial issue in the elections given the economic importance of the mainland to Taiwan. Chinese and some American officials privately say that victory for the KMT would be better for stability. An easing of confrontation could help remove barriers to direct transport links and closer economic interaction across the strait, for which Taiwanese businesses and the KMT are clamouring.

But can the KMT really achieve a breakthrough? The party is sensitive to public suspicions that it has gone soft on the communists and to demands for a stronger national identity—hence the KMT's decision to endorse a referendum law last November, a reversal of its previous policy. Mr Lien has said that if he wins, his first step would be a "journey of peace" to the mainland, before his inauguration in May. During this he would "demand" that China begin dismantling the missiles aimed at Taiwan. A fine idea—if hardly an original one. The problem is finding something to offer in return that both China and Taiwan's voters could accept.

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Cambodia

Deadlock

Feb 19th 2004 | PHNOM PENH
From The Economist print edition

A non-existent coalition and an invisible prince

SEVEN months after their general election, Cambodians still have no new government. The ex-communist Cambodian People's Party (CPP) led by the incumbent prime minister, Hun Sen, coasted to victory in July, but failed to win the two-thirds majority required under the constitution to approve a new cabinet. Just as predictable as the CPP's victory was the inevitability that the losers—Funcinpec and the eponymous Sam Rainsy Party—would frustrate efforts to form a new government. The latest round of talks is unlikely to produce a compromise.

The popular 82-year-old king, Norodom Sihanouk, calls the political games since the election a “ridiculous comedy”. He has made some pointed references to his own son, Norodom Ranariddh, who heads Funcinpec. The two opposition parties, now operating under the banner of Alliance of Democrats, have varied their demands between the unrealistic—no coalition with Hun Sen as prime minister, and tearing up all border treaties with Vietnam signed in the 1980s—and the call for a tripartite coalition. In November, Hun Sen and the CPP were said to have accepted the latter, but the opposition later denied that there had been any firm agreement. Prince Ranariddh then decided this was an excellent time to scurry off to Paris. He only recently returned to Phnom Penh, after a three-month sojourn.

Long-standing animosity and rancour between Hun Sen, Prince Ranariddh and Sam Rainsy are at the root of the current impasse. A wave of mysterious killings of opposition-minded figures has further clouded the saga and triggered accusations against the CPP of “dirty tricks”, while the woeful police investigation of the recent murder of Chea Vichea, a union leader, suggests that more energy is spent on extracting false confessions than in finding the real killers. But even the “democratic allies” do not trust each other. In the faction-ridden royalist party, many fear that Sam Rainsy is a bigger threat than Hun Sen to the survival of a declining Funcinpec.

The king has suggested scrapping the constitution's two-thirds rule to enable Cambodian governments to be formed on the basis of a simple majority. But the proposal has been met with little enthusiasm so far.

Prince Ranariddh has suggested that if the stalemate is not resolved by the Cambodian New Year in April, new elections will have to take place. His return home provided the impetus for a fresh round of talks, but the CPP opposes a three-party coalition. In any case, the “invisible prince”—as the king calls him—didn't stay any longer than the average tourist visiting Angkor Wat. After four days in Phnom Penh, he jetted off to Madrid to represent his party at a meeting of Christian Democrats and is now busy schmoozing the European Union.

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Iraq's Governing Council

A dangerous place between B and C

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From The Economist print edition

AFP

Having tasted power, the 25 members of Iraq's Governing Council quite like it

Get article background

IN THEORY, nothing much has changed. Though the violence continues—on February 18th suicide bombers killed at least 11 Iraqis and wounded nearly 60 coalition soldiers in a base at Hilla, south of Baghdad—the plan America announced last November still stands. Under that plan, America intends to transfer power to an Iraqi provisional government by July 1st. In practice, as all of Iraq knows, the details of this transfer of power are looking increasingly foggy.

The November plan was itself a Plan B, a much faster procedure than the one Paul Bremer, America's proconsul in Baghdad, had originally mapped out for giving Iraqis power over their own affairs. But Americans and Iraqis are now awaiting yet another plan, this time from Kofi Annan, the United Nations' secretary-general. This one, the Americans hope, will enable them to stick to their timetable while keeping the foremost spiritual leader of Iraq's majority Shia community, Ayatollah Ali Sistani, reasonably happy.

Mr Annan has the advantage that his own emissary to Iraq, Lakhdar Brahimi, was at least able last week to meet Mr Sistani in Najaf. Mr Bremer was never granted that honour and had to treat with the reclusive cleric via intermediaries. But squaring the differences between the ayatollah and the proconsul will still be hard. Mr Sistani had wanted the provisional government to be directly elected. Mr Bremer, insisting that Iraq lacks the machinery to organise such elections in time for the July handover, has stuck to the idea that a legitimate enough provisional government can be selected by local caucuses, with no proper elections until 2005.

No one is yet sure what the UN will propose. But rumour says the proposed compromise might be to bring those proper elections forward to the end of this year. The Americans, who in desperation have been signalling their flexibility, would then have to decide whether to adopt this as their plan C. And they would still have to work out how, when and indeed whether to create an Iraqi provisional government before then.

One complication is that Mr Bremer and Mr Sistani are not the only people who need to be satisfied by a

plan C. There are Sunni and Kurdish sensitivities to take into account as well. And on top of this is the vested interest of the existing Governing Council, the 25-member body that Mr Bremer himself appointed and which is the nearest approximation Iraq has right now to a government of its own.

When Mr Bremer produced Plan B in November, the council seemed happy enough to go along with it. Its co-operation was deemed crucial in making Mr Bremer's programme of caucuses work. But now that a Plan C is in the air, its members' enthusiasm for the caucuses is waning. Having tasted power, they are not in a hurry to give it up. If the new idea is going to be to hold earlier elections, some of the councillors ask, why should they not stay in charge of things until then?

Why indeed? Though appointed and not elected, the council is reasonably representative of Iraq's various groups. But it also has its flaws, one of which is a growing allergy to criticism. Its members say they believe in a free press but have shut down, albeit temporarily, the Iraqi operations of two of the Arab world's most popular satellite channels. They have formed a committee to investigate complaints of corruption, but have yet to name its head, its location or the sanctions at its disposal.

The councillors' nepotism rankles, too. Sons, nephews and cousins abound in ministries and on committees. And there are growing signs of authoritarianism. As before the war, senior officials honk furiously through the traffic jams of Baghdad, their convoys bristling with gun muzzles like hedgehogs. The chairman of the council's security committee, Ayad Allawi, has begun creating a new version of the feared secret police. Iraq may well need a counter-insurgency force, but Mr Allawi's rivals accuse him of recruiting former torturers to man a new apparatus of oppression.

Some council members are now calling for elections as soon as possible, starting in the more stable north and south, including ten mainly Shia provinces and three mainly Kurdish ones, but excluding the five provinces of Baghdad and the “Sunni triangle” where violence is concentrated. It may be that a proper democratic spirit animates such calls. But, this being Iraq, there are those who see the councillors' haste as a complex ruse to stymie any alternative to their own continuation in office.

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The International Court of Justice

Law and peace

Feb 19th 2004 | THE HAGUE
From The Economist print edition

The judges and Israel's wall

CAN lawyers succeed where the statesmen have failed? Probably not. But as a delegation from America's National Security Council and State Department visited Israel this week to look into Ariel Sharon's proposal to withdraw unilaterally from the Gaza Strip, lawyers in The Hague were bracing for their own moment in the spotlight. They will be debating the legality of the security wall Israel is building around and within the West Bank.

Most governments and many international lawyers think that the wall is illegal. Four months ago, the UN General Assembly demanded that Israel reverse its construction. But building has continued. Israel's Supreme Court is currently examining a petition from two Israeli civil-rights groups against the barrier. Should the International Court of Justice (ICJ), the world's highest court, now also weigh in and give an "advisory opinion" on the legality of the barrier, as the UN's General Assembly has asked it to do?

On this, the world is far from agreement. The United States, Britain and most other countries of the European Union argue that a ruling by the ICJ would envenom the debate, impeding efforts to reach a negotiated settlement of the wider conflict between Israel and the Palestinians. It would also be inappropriate, they say, for the world's highest court to embroil itself in such a politicised dispute. Israel goes further, claiming that the court has no jurisdiction in the matter. Most Arab countries, however, contend that a failure by the ICJ, the world court, to intervene would inflame passions and do irreparable damage to the court's credibility.

This is one of the most politically charged cases ever to come before the ICJ. Emotions are running high. Written submissions have been made by 44 countries including the United States, Israel and most EU countries, as well as from the Palestinian Authority (PA), the League of Arab States and the Organisation of the Islamic Conference. But Israel, the United States and the EU countries have all now decided to boycott the oral hearings due to begin on February 23rd. That leaves only 13 countries, mostly Muslim ones, along with the PA, the Arab League and the Islamic Conference, intending to take part.

Israel argues that the proposed 400-mile system of trenches, fences, wire and concrete walls is a temporary measure designed to defend Israelis against suicide-bombers and other Palestinian attackers, who have already killed some 900 Israelis in the past three and a half years. Its affidavit to the court says that the request for an advisory opinion (only 90 of the UN's 191 members voted in favour of this, with 74 abstentions and eight votes against) flew in the face of the hoped-for peace negotiations and gave "a green light to further attempts to bring the Middle East dispute piecemeal to the court and away from the negotiating table".

An advisory opinion can only be given on a "legal question", Israel argues. But the UN's request for an opinion on "the legal consequences of the construction of a wall in the occupied Palestinian territory" was "so vague and uncertain as to be incapable of being considered a legal question". Furthermore, "the court cannot, and should not, try to place itself in Israel's shoes in determining the means by which Palestinian terrorism should be dealt with." Israel had not given its consent for the dispute to be referred to the ICJ, as required under the court's rules. And "Palestine" was not entitled to appear before the court, not being a sovereign state or, therefore, a party to the court's statutes.

The Palestinians do not challenge Israel's right to defend itself. But they claim that the planned construction of the barrier on occupied land in the West Bank is illegal. By reaching deep into occupied territory, sometimes even encircling entire Palestinian towns and villages, the proposed route would disrupt the lives and violate the human rights of hundreds of thousands of Palestinians, they say. They fear that the barrier will become a permanent structure, resulting (under present plans) in the

“annexation” by Israel of some 15% of the West Bank.

Since being set up in 1946 with the task of settling disputes between states, the ICJ has delivered 76 judgments, which are binding, and 24 advisory opinions, which are not. For a judgment, both parties to the dispute must give their consent to a referral to the court. For an advisory opinion, no such consent is required. In theory the court can decline to give an advisory opinion, but it must have “compelling reasons” for doing so. It cannot simply pick and choose. In the 58 years of its existence, it has never yet turned down such a request. To do so now would make it more vulnerable to outside pressure in future cases.

The court has faced controversy before. In 1996 the UN asked for an advisory opinion on the legality of the use of nuclear weapons. (The court advised that in most cases it probably was unlawful, breaking the rule of “proportionality” in a case of self-defence, and contravening humanitarian law requiring the protection of civilians in the event of use in war.) But the ICJ was not then faced with a boycott by most of the western world.

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South Africa

Facing up to the past, again

Feb 19th 2004 | JOHANNESBURG
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Rethinking reconciliation

AP

Where's the money, asks Bishop Tutu

“NELSON MANDELA is an albatross round our necks,” moaned the (black) author of a letter to a South African newspaper last week. Others wrote to agree. Sniping at the beloved former president is rare, but some South Africans think his policy of promoting reconciliation between blacks and whites has lasted long enough. Too few people have been held to account for apartheid crimes, they say. Compensation for the victims of those crimes has been paltry. And the firms that operated in South Africa despite UN sanctions have paid no price.

Mr Mandela's approach was to forgive and move on. His successor, Thabo Mbeki, has so far stuck faithfully to it, but there are signs of a shift. Last week Gideon Nieuwoudt, a former police colonel, was arrested over the murder of three anti-apartheid activists in 1985. He is also implicated in a car bombing in 1989.

The national prosecution authority says more arrests and “major cases” will follow. At least one former general is under investigation. Eugene de Kock, a former police commander imprisoned in 1996 for a grisly catalogue of murders, said last week he would testify against as many as eight ex-generals if they were arrested.

The government is trying hard to get more apartheid officials to admit wrongdoing. Nearly 7,000 policemen, soldiers, spies and others applied for amnesty to the widely lauded Truth and Reconciliation Commission (TRC), which offered immunity from prosecution in return for full disclosure. Only some 1,200 were granted amnesty, however. Many, such as Mr Nieuwoudt, were turned down because the commission felt they had not told the whole truth. The justice minister, Penuell Maduna, said last week that unless more apartheid officials volunteered information about their crimes, the government might resort to “many miniature Nuremberg-type trials”.

He may have been posturing; an election is due in April. But be that as it may, his words were popular. The arrest last week of four men, including a white builder, accused of beating a black worker senseless and feeding him to a lion, has sparked a tense debate over race relations. Former president F.W. de Klerk worries that racial divisions threaten democracy.

Archbishop Desmond Tutu, the former chairman of the TRC, wants more help for the 22,000 victims whom the commission identified. Last April, the government agreed to give some 30,000 rand ($4,500) to each, a fifth of the sum recommended by the TRC. “We have been less than generous with people who have been remarkable,” said the bishop.

Finding no satisfaction at home, Mr Tutu has given evidence in support of one of four lawsuits in American courts against international and South African banks, oil companies and other “snooty” firms that broke sanctions. Billions of dollars of reparations are sought; a New York district judge, John Sprizzo, is now due to decide whether the case can continue.

The South African government opposes such cases, fearing they may scare off investors. It would prefer that the plaintiffs settle their grievances in domestic courts. That is unlikely to happen, not least because American juries tend to be more generous. Meanwhile, the South African government will probably find a way to spare those who confess to political crimes committed during the apartheid era from prosecution. Among those denied amnesty by the TRC were 37 top members of the African National Congress, South Africa's rebel movement turned ruling party. The list includes Mr Mbeki.

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The great sugar shortage in Eritrea

Sweet nothing

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A country's last luxury vanishes

THEY may be suffering drought, famine and tyranny; they may be constantly on the verge of war with their far more numerous neighbours, the Ethiopians; but the people of Eritrea only seem to care about one thing. Their country has run out of sugar.

Nobody knows how it happened. (There is no free press in Eritrea, so no one knows much for sure.) One theory is that the government, aiming to prevent sugar wholesalers from making a profit, introduced so much new red tape that they stopped importing the stuff. Prices tripled. Rationing was introduced. Soon sugar became unobtainable at any price. Eritreans are used to hardship, but this has made life intolerable.

Sugar is the only luxury many Eritreans enjoy. Qat, a hallucinogenic plant popular in neighbouring countries, is banned. Alcohol is expensive. The state television is not worth watching, even if you have electricity. Eritreans get their buzz from strong, sugary coffee.

They consume it with great ceremony, much as genteel Japanese people do tea. Even the simplest homes have the necessary paraphernalia for a coffee ceremony. The ritual is held twice a day in most homes, and can last for hours. Beans are ground and roasted, then brewed over a small charcoal burner. Tiny cups, half-filled with sugar and topped up with thick, black coffee are handed round, along with sugared popcorn. The process is repeated three times. It is rude to leave early.

Sugar is an essential part of Eritrean life. Women bring lovingly gift-wrapped bags of it to weddings and baptisms. In the parched and barren countryside, children are weaned on sugared water. Veterans of the country's 30-year liberation war recall that even when other supplies dried up, there was somehow always sugar for the troops.

Given all this, it seems extraordinary that the government should now allow it to run out. Sadly, since its current policy appears to be to stifle private enterprise, sugar will probably not be the last thing Eritrea runs short of.

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African leaders invite criticism

Well, a little

Feb 19th 2004 | KIGALI
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A plan with teeth, but not sharp ones

TWO years ago, when the African Union launched a plan to promote better governance in Africa, its centrepiece was a “peer review” mechanism to force corrupt, incompetent or authoritarian regimes to shape up. Unlike previous plans, the New Partnership for Africa's Development (Nepad), brainchild of South Africa's president Thabo Mbeki, was to have teeth.

Last weekend, at a summit in Kigali, the Rwandan capital, those teeth were finally bared, and they were less than fearsome. The peer-review mechanism will consist of “panels” that will help countries conduct “self-assessments”, which their rulers will “consider”.

Each study will last for up to nine months, and involve discussions with the government, the opposition, unions and so on. The process will be voluntary. Ghana, Rwanda, Mauritius and Kenya will go first, and 13 others have signed up. Reviewers will not examine whether countries are meeting acceptable standards of clean government, democracy and human rights, but only whether they are moving towards these goals.

Final reports will not necessarily be published. Leaders at the summit could not agree on this; some bluntly stated that they would not like a report to come out, say, just before an election. The credibility of the process will depend on how the reviewers handle sensitive issues. In Rwanda, for example, they will confront a country that has held elections, but only after opposition parties were banned or curbed. In Kenya, they will have to assess whether corruption is subsiding or not.

Encouragingly, there is no shortage of countries wanting to be judged. The seven-member peer-review panel decided to start with those it believed were, logistically speaking, ready. Mozambique's president, Joaquim Chissano, said that simply preparing for an appraisal exposed flaws—and fostered improvements—in his country's economic policies. But another head of state questioned why, if he had won an election with a large majority, reviewers would need to talk to the opposition.

Wiseman Nkuhlu, Nepad's top official, thinks that those outside the mechanism will feel pressured to join, since aid and investment will tend to flow to those awarded a clean bill of health. Then again, the countries least likely to submit, such as Zimbabwe, would not attract investment whatever Nepad says.

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Russia and the European Union

Dark skies to the east

Feb 19th 2004 | RIGA, MOSCOW AND BRUSSELS
From The Economist print edition

Reuters

Strategists in Brussels no longer talk sweetly of encircling the enlarged European Union with a "ring of friends"

NOW that the German Question has been solved, the Russian Question beckons. Can Russia, after centuries of autocracy and imperialism, be turned into the sort of nice democratic country that gets along easily with its European neighbours? The answer seems to be: not for a while yet, to judge from a policy paper released last week by the European Commission, the European Union's executive body, which suggests that relations between the Union and Russia are close to a post-Soviet low.

The Commission calls for "discussing frankly Russian practices that run counter to universal and European values". It says Russia has problems with democracy, human rights and press freedom. It points to rows over the environment, trade, border regimes and technical co-operation. It says aid to Russia has had "at best mixed" results; and it chides Russia for "assertive" behaviour towards neighbours.

Some of these arguments go back years. But they are getting more heated with the approach of the EU's eastward enlargement in May. The EU will embrace ten countries in all, seven of which were subjects or satellites of the Soviet Union. As these countries impose tight EU visa rules, and close their markets to Russian goods, such as noisy aircraft which fail to meet EU standards, Russia has been jolted into realising that EU enlargement will affect it much more in practical terms than the eastward advance by NATO, which used to monopolise its attention.

So Russia has redirected its diplomatic firepower. It wants to renegotiate its "partnership and co-operation agreement" with the EU, which is supposed to govern all aspects of the relationship. It has also put forward a list of 14 big items, from trade concessions to visa-free travel, that it wants brought into the negotiations. It has threatened to let the treaty lapse—though EU officials claim that Russia itself would lose more from that course, by risking trade privileges with the EU.

The EU also says that Russia, for all its demands, has shown little recent enthusiasm for detailed talks. The distractions of Russia's parliamentary election in December and an approaching presidential one in March may be partly to blame. But there is more to it than that. Russia resents being informed—as happens now—of EU positions which have already been agreed among governments and so are scarcely changeable. It wants new joint bodies which will give it a seat at the table when EU governments are debating decisions that may affect its interests. It wants something more like the arrangement it has with NATO, where its representatives sit alongside those of NATO governments in a ministerial council

and a cascade of lesser panels, enjoying “a voice but not a veto” in alliance deliberations.

The European Commission hates that idea, fearing that Russia-EU relations would then become hostage to bilateral ties between national governments and Russia, in which the latter could dominate more easily. Memories are fresh of the EU-Russia summit in November when Italy's prime minister, Silvio Berlusconi, supposedly representing EU governments, disowned EU positions: he sympathised with Russia's war in Chechnya and its harassment of the Yukos oil company.

The Commission's latest analysis of Russia marks a sharp change from its starry-eyed optimism of a year ago, when it published a document called “Wider Europe” saying that Russia, and other countries of eastern Europe and the southern Mediterranean, could be turned into a “ring of friends” around the enlarged Union, absorbing the Union's political and economic values and being rewarded with aid and improved market access.

What Russia and the EU want from each other

Russian wish-list	EU wish-list
More Russian involvement in EU decision-making	More respect for democracy and the rule of law in Russia
More EU support for Russia's bid to join the WTO	Less brutality in Chechnya
Official status for the Russian language in Estonia and Latvia	Russian support for free and fair elections in Ukraine and Belarus
Greater EU reliance on Russian oil and gas	Reform and liberalisation of the Russian gas industry
Free transit through Lithuania for Russian freight and military traffic to Kaliningrad	Extension of the EU-Russia Partnership and Co-operation Agreement to the enlarged EU
Trade concessions mainly over steel, farm products, nuclear equipment and aircraft	Russian support and ratification of the Kyoto protocol on climate change
Visa-free travel between the EU and Russia	Russian pledge to take back illegal migrants

The EU failed to see that Russia is once again driving hard bargains in the world; it is less interested in friendship than it is in commercial and diplomatic gains. The EU forgot that Russia is fed up with foreign-dictated reforms, having had its fill of them in the 1990s. Nor does Russia have all that much to gain from wider access to EU markets for most goods and services. Its biggest exports are oil and gas, limited only by the EU's fear of over-dependence.

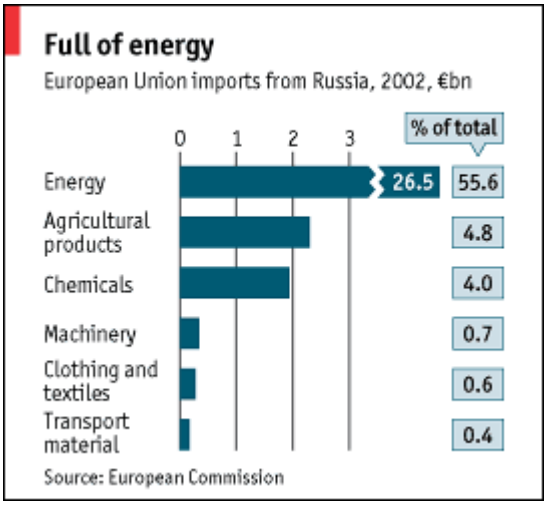
Wherever the Russian Question now leads, the question of eastern Europe will follow. The EU's “Wider Europe” strategy also calls for closer ties to Belarus, Ukraine and Moldova, new neighbours of the enlarged Union. Poland talks of offering them full membership some day. But Russia sees them as its own close strategic allies, as its natural business partners, and as members of an enlarging Russian-led free-trade area. It will hardly look on sweetly if the EU tries to lure away its key allies.

All this means that EU governments face big decisions in the coming months. One is whether to stand firm in the current sparring with Russia. That could mean letting the “partnership and co-operation” accord collapse. The consequences could be offset by temporary arrangements, but the symbolic damage would be far-reaching.

Another is how to respond if Ukraine's presidential election and Belarus's parliamentary election, both due in October, are too blatantly rigged. November's peaceful revolution in Georgia, another ex-Soviet republic, has provided a tempting precedent. There, encouraged by America, opposition forces profited from public anger at a gerrymandered election to overthrow an incompetent (though pro-American) president, Edward Shevardnadze, and to vote in a younger and probably more effective pro-American leader, Mikhail Saakashvili. Russia will be on guard now against any similar foreign-led move in Ukraine or Belarus.

It has reason to worry. Some Americans scarcely conceal their hope for a revolution against Belarus's wild-eyed and dictatorial leader, Alexander Lukashenka, or against Ukraine's entrenched and corrupt *nomenklatura*. Central Europeans will tend to agree unreservedly. They want to see Russia challenged and contained. The EU's older members will tend to be much less gung-ho. They are impatient already with the political and economic demands of the current enlargement, and have little wish to get drawn deeper into eastern Europe, nor to argue

with Russia any more than necessary. Finding a common policy towards eastern Europe that satisfies old and new EU members will be a big challenge for the enlarged Union. Finding one acceptable to Russia too, if that is a criterion, will be harder still.



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The European Union

Ménage à trois

Feb 19th 2004 | BERLIN
From The Economist print edition

The Union's tentative triumvirate will alienate others

AP

Is Albion still perfidious?

Get article background

IT IS always irksome not to be invited to an exclusive party. But when Gerhard Schröder, the German chancellor, hosted a dinner in Berlin for Tony Blair and Jacques Chirac on February 18th, the 12 other European Union leaders who had not received invitations were irritated for reasons that went well beyond hurt feelings.While the results of the Berlin summit seemed slight and inoffensive—economic reform in the EU—political leaders across Europe were left wondering whether the hidden agenda was a bid to establish a “big three” that will dominate the EU.

This is a moment of heightened uncertainty for the Union. On May 1st, another ten members—mainly from central Europe—will be formally admitted to the EU, swelling its membership to 25 countries. Many fear that the EU will become impossibly unwieldy. Ministerial meetings have already been held with 25 countries present for some months—and early reports are far from promising. Ministers are staggering out of meetings in Brussels, complaining that it takes hours just to get through the opening statements. One senior French politician fumes that gatherings of 25 ministers are such a waste of time, he may simply stop turning up.

Against this background, there is an obvious temptation for the bigger countries to try to “pre-cook” the Union's decisions by meeting in smaller groups. This is known in Brussels parlance as a *directoire*, and the Berlin dinner looked to many like a trial run. After their feast, the trio proposed a new deputy head of the European Commission charged with economic reform. Whatever the merits of this idea, the other EU countries were also concerned that as they munched through their dumplings and sauerkraut Messrs Blair, Chirac and Schröder would try to thrash out a trilateral deal on the proposed EU constitution.

This, of course, is the sort of thing that the “Franco-German couple” have done for years with great success. The novelty is that Britain is now involved. The invitation to Mr Blair may reflect the fact that France and Germany have discovered over the past year that their combined weight is no longer sufficient to guarantee a result in the enlarged EU. On two of last year's key issues—the Iraq war and the EU's constitution—Franco-German agreement was not enough to carry the day.

Whether simply adding Britain to this duo will suffice to create a new leadership for the EU must be open to question. Nor is it clear that the British view of Europe—pragmatic, economic and opposed to deeper

integration—will ever really mesh with the traditional Franco-German approach, which is visionary, political and dedicated to “ever closer union”. Their views on economic reform also differ. In Berlin Mr Chirac called for EU encouragement of industrial champions, an idea which Mr Blair would call much too old-fashioned.

Yet for the British at least, there is no harm in trying. Mr Blair has the advantage of having an alternative alliance of Italy, Spain and Poland as a possible fall-back position. As one sage observer in Brussels puts it: “It's the old British game in Europe of divide-and-rule and balance-of-power. This is the policy they have been pursuing for the last 400 to 500 years.”

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German industrial relations

Slowly losing their chains

Feb 19th 2004 | BERLIN
From The Economist print edition

Labour relations are changing, but not enough

Get article background

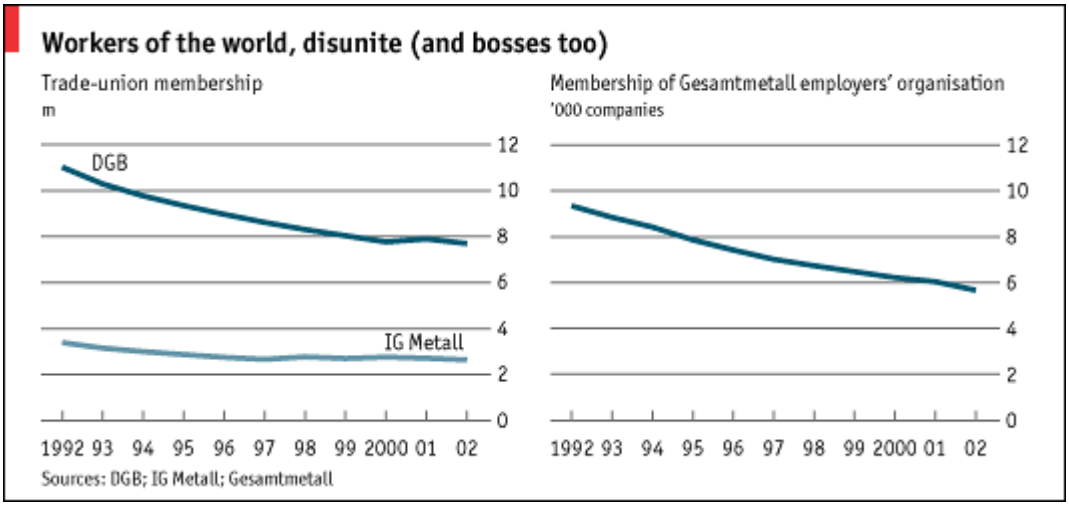
THE more Germany changes, the more its industrial relations look the same. On February 12th, after the usual rhetoric, warning strikes and negotiations into the wee hours, employers and trade unions in the engineering sector reached an equally predictable agreement: modest pay rises of not much more than 2% and limited flexibility over working time.

Yet despite this seeming sluggishness, Germany's industrial relations are undergoing profound changes—perhaps more than the welfare system whose reform is also much discussed. In areas such as pay-setting and employee participation, Germany has long been a special case among industrial democracies. In contrast to Britain and the United States, where employment contracts are negotiated company-wide or individually, the country still has an extensive system of centralised, industry-wide collective bargaining, with almost 60,000 agreements. Unions also have a say in how firms are run. If a company has more than 2,000 employees, half of the seats on its supervisory board must go to employee representatives; they call this system co-determination.

Arguably, these principles have served Germany well—and help explain why the country lost a mere nine working days per 1,000 workers annually between 1992 and 2001, against 22 days in Britain and 48 in the United States. Industry-wide bargains spare companies from having to negotiate their own pay deals; and the practice of co-determination has smoothed the way for corporate restructuring.

Yet since the early 1990s, the drawbacks of the system have become apparent. Pay rises were too high, adding to Germany's unemployment. Moreover, centralised bargaining is a blunt instrument: it cannot allow for variations within a sector, nor for the specific needs of a firm. As for co-determination, that system has started to look rather out of step with the imperatives of an accelerating global economy.

Seen from outside, the edifice of German industrial relations has withstood global pressures surprisingly well: in 2001, 63% of employees in the country's west and 44% in the east were still covered by collective agreements. Yet the bedrock is crumbling. Employers' associations, in particular in the engineering sector, are losing members even faster than unions (see chart)—and not just in the east where a mere 22% are now bound by a union pay deal (against 45% in the west). Worse, firms are moving jobs abroad.



To keep the structure from collapsing, unions have tolerated, often tacitly, company-level agreements that diverge from the industry-wide deals. Today, about a third of private-sector firms have negotiated such pacts, often called “Alliances for Employment”, with their workers' councils in order to lower costs, improve productivity or allow for more flexible working hours. To accommodate this trend, unions are leaving room in collective agreements for company-level pacts. Over the 1990s, the number of German workers affected by this sort of loophole went from zero to 6.6m.

Some recent studies suggest that co-determination has not prevented companies from innovating. Recent testimony by Klaus Zwickel, the former boss of the IG Metall Union, suggests why. It has been “common practice” for employee representatives on boards to abstain from voting on big decisions such as management pay, he said at the ongoing trial against members of the board of Mannesmann, a wireless carrier, for awarding huge bonuses after Vodafone's takeover of the firm. As Mr Zwickel explained, representatives of the workers wanted to let firms pay spectacular salaries but avoid the jibes of their comrades.

Has this sort of arrangement proved flexible enough for firms to remain competitive internationally? No, particularly when it comes to pay-setting, critics say. They point to the latest collective agreement in the engineering sector: employers and unions failed to agree fully on a clause that would have allowed firms to vary the length of the working week between 35 and 40 hours. In fact, as long as the cartel of bosses and unions persists, the system will never be decentralised enough to lower costs and thus unemployment.

German law should therefore be changed to remove the bias in favour of collective deals, says Norbert Berthold, an economics professor at Würzburg University. Above all, firms should be allowed to diverge from their sector's pay deal if two-thirds of employees are in favour—without waiting for union approval. In fact, such legislation is unlikely to be passed in the near future. Chancellor Gerhard Schröder has abandoned any such thoughts—for fear of upsetting his fellow Social Democrats. But unions should not think they are safe. Unless they grasp the nettle of company-level pacts and waiver clauses more boldly, firms will manufacture elsewhere; or a different party will take power, bringing closer the dreadful day when German labour relations resemble those of Britain or America.

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Turkish women

Thou shalt not kill

Feb 19th 2004 | ANKARA
From The Economist print edition

The mosques at last proclaim a woman's right to live

AFP

Erdogan and the missus

A SHARP new message will soon be delivered to the 15m men who gather every Friday in mosques all over Turkey to imbibe the latest spiritual guidance, on anything from foreign policy to personal cleanliness, from the country's state-appointed prayer leaders. Worshippers will be told that “honour killing”—the murder by men of female relatives deemed to have besmirched the family's moral standing (for such heinous crimes as going to the cinema with a man who is neither husband nor kin)—is not just a breach of the law. Such acts are also a sin against God, the preachers will say: they contravene the Prophet's teaching on clemency.

The idea of using Muslim sermons to stamp out one of most grisly practices of traditional society, of which dozens of cases still occur every year, belongs to Ali Bardakoglu, the new head of Turkey's Religious Affairs Directorate. This is a state institution which reflects Turkey's paradoxical mix of official secularism and popular piety. Its job involves micro-managing religious life and telling preachers what to say.

The directorate's new emphasis on protecting women has cheered western-minded Turks. When the current mildly Islamist government came to power, liberals and feminists feared that this powerful agency might start pedalling backwards. But Mr Bardakoglu amazed women's groups by seeking their help in penning a homily in time for International Women's Day on March 8th; and the stark warning against “honour killing” is among the results. “It's revolutionary,” says Halime Guner, of Flying Broom, one of the movements consulted by Mr Bardakoglu.

There have been other nice surprises for liberals. Earlier this month, parliament approved a draft law banning discrimination against homosexuals; it is working on another which would make crimes committed in the name of family “honour” as severely punishable as any other. Some of Turkey's staunchest westernisers grudgingly admit that, since coming to office in 2002, the ruling Justice and Development Party has done more than its secular predecessors to advance social reform. This is at least partly because Turkey's rulers want to join the European Union, which makes social change imperative.

Not all Turkey's advocates of secularism are satisfied that the ruling party has changed its spiritual spots. Some western-minded civil servants grouse that they are being sidelined in favour of men whose wives cover their heads, Islamic-style. But on that issue there are cries of discontent from other quarters—including the women whose headgear bars them from setting foot in schools, universities or government offices.

Recep Tayyip Erdogan, the prime minister, has promised the country's powerful and strictly secular generals that he is in no hurry to assert the right of women to wear headscarves in public places. In another sop to them, he has quietly decided that no ladies in scarves will represent the ruling party in safe seats in next month's municipal elections. That will dismay his more devout female supporters. But, as Mr Erdogan knows, in these matters you cannot please everybody all at once.

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France's National Front

A ghost exorcised?

Feb 19th 2004 | PARIS
From The Economist print edition

France's far-right leader is barred from an election

Get article background

IF ONE unmentionable spectre has haunted the ruling centre-right party in France in recent weeks, it is that of Jean-Marie Le Pen's far-right National Front. Two years ago, it beat the Socialists into third place in the first round of the presidential election. Today, one minister calls it “a very serious preoccupation”.

A party official fears it is “structurally impossible” to diminish the Front's appeal. How convenient then that, this week, just a month before the regional elections, the main ghost may have been exorcised. A prefect in the southeastern swathe of France with the long name of Provence-Alpes-Côte d'Azur has deemed Mr Le Pen ineligible to stand there.

The decision rests on a technicality. By law, candidates need either to live locally, or to pay local taxes. Mr Le Pen lives in a swanky suburb of Paris, but rents a flat in Nice. The lease is in his name, but the local taxes are paid by the National Front. A local court had refused to order the tax authorities to issue him with a certificate of residence. The prefect then deemed his candidacy invalid.

Mr Le Pen's ineligibility is not yet definitive. He has until February 27th to secure the necessary proof. Failing that, he can still appeal. His party is planning a big parade this weekend in Marseilles to support him. But time is running out. Campaigning starts on March 8th, and the poll's first round is on March 21st.

Naturally, conspiracy theories are now swirling. Mr Le Pen himself has talked of “skulduggery” and “orchestrated persecution”. There are certainly plenty of parties with an interest in seeing him magically wiped from the ballot papers. The regional election will be the first “mid-term” test of President Jacques Chirac's government, and the far-right vote will be the most important measure of protest. Mr Le Pen is standing in the one region where the National Front has a chance of grabbing power. Currently in Socialist hands, the region known inelegantly as PACA, reaching from Marseilles to the Alps, is the party's heartland: it secured a hefty 27% at the 1998 regional elections, up from 18% back in 1984. In 2002, 23% of the region voted for Mr Le Pen as president, against 18% nationwide. The second round looks set to be an awkward three-way contest with the centre-right and the Socialists. Short of an improbable alliance between those two foes, which would volunteer to withdraw in order not to split the anti-Le Pen vote?

Odder still is the whispering that Mr Le Pen himself may not want to go through with the vote. It is indeed strange that this veteran campaigner failed to sort out his paperwork. Bruno Mégret, an ex-friend and rival far-rightist (who has also been barred from standing) claimed that Mr Le Pen wanted to “throw in the towel” because he feared losing. More intriguing is the possibility that he fears winning: victory would mean having to turn his mind to the tedium of managing a region, rather than stomping about lambasting everybody.

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Charlemagne

Europe's Jewish question

Feb 19th 2004
From The Economist print edition

American charges of anti-Semitism are not all hyperbole

Get article background

A SENIOR official at the European Commission travelled recently to a family gathering in the United States. The official, who is Jewish, was startled by his reception. “People treated me like I'd arrived from occupied Europe,” he says. “They seemed convinced that Europe has been engulfed by anti-Semitism.”

It is not surprising if American Jews have this impression. Some of America's leading journalists and diplomats have given credence to the idea. George Will, writing in the *Washington Post* in May 2002, argued that anti-Semitism among Europeans and Arabs “has become the second—and final?—phase of the struggle for a ‘final solution to the Jewish question’.” Rockwell Schnabel, the American ambassador to the European Union, told a dinner organised by the American Jewish Committee in Brussels this month that anti-Semitism in Europe “is getting to a point where it is as bad as it was in the 1930s.”

Come again? By the mid-1930s Germany had passed laws excluding Jews from state employment and forbidden marriage between Jews and gentiles. Nothing like this is happening in Europe now. The fact that such accusations of European anti-Semitism have been so wildly over-stated helped to ensure that the initial European reaction to these charges was usually anger and denial. Many European politicians argued, at least in private, that the charge of anti-Semitism was being used to intimidate critics of Israel, or of American policy in the Middle East.

But European politicians are now coming round to the idea that there may be something to discuss. This week, the president of Israel, Moshe Katsav, paid an official visit to France, the first by an Israeli head of state for 17 years. Jacques Chirac, the French president, promised to be “uncompromising” in combating anti-Semitism in France (although he also complained of “groundless accusations that are sometimes made against us”). Later in the week, the European Commission was due to hold a seminar on anti-Semitism with such luminaries as Joschka Fischer, the German foreign minister and Elie Wiesel, the Nobel peace prize winner and Holocaust survivor.

Some might conclude that the Europeans have found it more politic to respond to accusations of anti-Semitism with seminars than with anger. But that would be too cynical. The fact is that, stung in part by American jibes, many Europeans have begun to recognise that while they may not be on the brink of a new Holocaust, there has indeed been an alarming outbreak of anti-Semitism in parts of Europe in recent years. The problem has been most acute in France, home to Europe's largest communities of Jews and Muslims, at 600,000 and around 5m respectively.

In 2002 the main synagogue in Marseilles was burned to the ground. Last November a Jewish school on the outskirts of Paris was also gutted by arson. Street assaults on Jews have become common enough for the chief rabbi of Paris to advise Jewish boys to cover their heads with a baseball cap rather than a traditional kippa. Similar attacks on Jewish targets, albeit on a smaller scale, have been reported from several other European countries, including Belgium and the Netherlands. After initially ignoring the issue, European politicians began to speak out. Shortly after taking office, Jean-Pierre Raffarin, the French prime minister, declared: “Attacking a Jew is tantamount to attacking the French republic.” The French government has stepped up protection of potential Jewish targets, and told teachers to crack down on anti-Semitic taunts among their pupils.

Some EU officials, ever in search of the elegant compromise, predict a new consensus. Europeans will admit anti-Semitism is a problem and try tackling it; Europe's American and Israeli critics will tone down their attacks. But maybe that is too hopeful. It is easy to agree that assaults on Jews in the streets are

bad. But there are other issues on which rancour will persist. When does legitimate criticism of Israel blur into anti-Semitism? And is there a wider problem of European anti-Semitism, going beyond the Muslim-dominated ghettos?

One trigger for recent accusations of endemic anti-Semitism in Europe was a poll conducted by the EU which ostensibly showed that Europeans rated Israel as the biggest threat to world peace. It was partly in response to the poll that the commission called its seminar. Clearly, there are cases where a line is crossed between harsh criticism of Israel and something more sinister—but where to draw the line? Some argue that European criticism of Israel is so one-sided that it must reflect a broader anti-Semitism in society. There is polling evidence to suggest that anti-Semitic attitudes remain disturbingly durable in Europe. But these attitudes are not confined to Europe. A poll conducted on behalf of the American-based Anti-Defamation League found in 2002 that 30% of people in ten EU countries agreed with the statement that “Jews have too much power in the business world”. Another ADL poll in the same year also found that 24% of Americans agreed with the same statement.

Muslims, too, are in the firing line

However strong anti-Jewish sentiment is in Europe, Muslims face even deeper levels of prejudice. In a recent French poll, 10% of people admitted disliking Jews, but 23% expressed prejudice against North Africans. Xenophobic parties such as France's National Front are making gains primarily on the back of prejudice against Muslims, not Jews. So European leaders face a dilemma. It is both convenient, and largely accurate, to blame the rise in anti-Semitic acts on disaffected Muslim youths. But the same leaders are acutely conscious of the need to foster Muslim assimilation into mainstream society, and to combat the racism that fuels the far right. The pat solution is to insist that all citizens embrace tolerance and free debate—and accept the need for post-Holocaust Europe to be ultra-vigilant against anti-Semitism. But that argument resonates better in a seminar room than it would on a housing project outside Paris.

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Crime

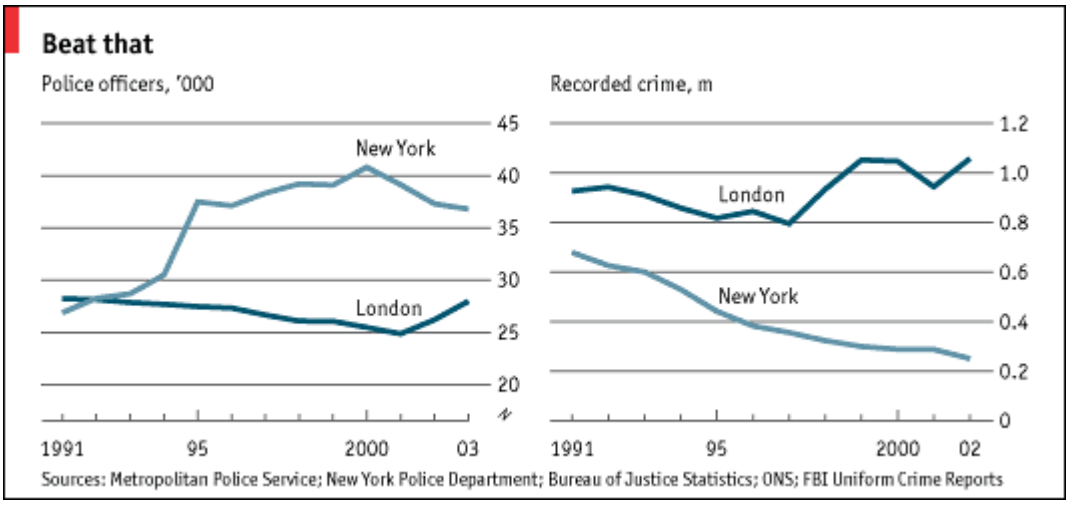
London's cops look to New York

Feb 19th 2004
From The Economist print edition

London's mayor Ken Livingstone wants to introduce New York-style policing. It is more difficult than it sounds

WHEN “Red” Ken Livingstone ran London in the early 1980s, he enjoyed cocking a snook at authority over everything from outsize public transport subsidies to Irish terrorism. But reincarnated as the capital's ardently business-friendly, market-minded mayor, keen on road pricing and selling the city abroad, Mr Livingstone has changed his tune on the law. He's now a strong supporter of intensive, highly visible policing.

This week, the London Assembly approved the first stage of a plan that will greatly increase the uniformed presence on the capital's streets. In April, around a hundred neighbourhoods will get three extra coppers and three community support officers each. Mr Livingstone's eventual goal is to raise police numbers to 35,000—meaning one in every 115 employed Londoners will be a police officer.



It will be a different kind of police, spending more time walking the beat and paying attention to the sort of minor offences that are thought to encourage more serious stuff. Sir Ian Blair, deputy commissioner of the Metropolitan Police, talks about disrupting the “criminal habitat”, deterring villains before they start.

The ambitions, and many of the methods, come from New York, which has a similar population to London. As Mr Livingstone likes to observe, a city that once exemplified lawlessness has cut robbery and murder rates by almost three-quarters since the early 1990s. That compares well to London, where recorded street robberies have almost doubled in ten years.

Initially, the idea was to copy the “zero tolerance” approach of New York's former mayor Rudolph Giuliani and William Bratton, the police commissioner from 1994 to 1996. This interventionist method, also known as “broken windows policing” assumes that minor, unpunished crimes encourage more law-breaking. It's a sensible notion, but results in Britain have so far disappointed. The thinking now is that the new techniques worked in New York because police numbers rose a lot too.

Mr Livingstone hopes to pull off the same trick. He goes into this year's mayoral elections saying that he will be disappointed if crime in London does not halve.

That's a brave and probably a foolish pledge. New York's recovery certainly started with a clampdown on

anti-social behaviour—graffiti writing, street drinking, turnstile jumping, and so on. But these low-level miscreants were then shackled, fingerprinted, and (if they didn't have identification) often held overnight in police cells. Over time, the police built up a store of information that they used to solve all sorts of crimes. British police, with their milder approach and heavier form-filling burden, will find these methods hard to copy.

Secondly, away from the neighbourhoods that British politicians tended to visit, New York's cops were trying out more aggressive methods such as undercover buy-and-bust operations, neighbourhood sweeps and “vertical patrols”, in which entire tower blocks were raided. These did more to take bad guys off the streets than harassing squeegee men.

This style of policing only works if citizens are willing to suffer it. In mid-1990s New York, they clearly were. In 1996, the *New York Times* ran an entirely serious article about what to do when you get arrested (cross your wrists when the handcuffs go on; call the cops “sir” or “ma'am”; carry coins for the precinct payphone).

With the murder rate down, but still close to 1,000 per year, trading liberty for security seemed an excellent idea. But in London, where the murder rate hovers around 200 a year, the chattering classes are unlikely to tolerate the occasional handcuffing. And as Sir Ian points out, London has no large areas of unremitting poverty and criminality to match those of New York. Twirl a truncheon on just about any street in the capital, and you are likely to hit a vocal middle-class head.

Other differences also count against London. New York's area is about half London's, so its police are more concentrated. Scotland Yard is also stretched by responsibilities outside London. And the New York police were in a truly parlous state before Messrs Giuliani and Bratton arrived, so the improvement was striking.

Another difference is pointed out by George Kelling, the Rutgers University academic who is the most influential exponent of the broken windows theory. Don't just look at new policing ideas, he says; look at how they are turned into practice. In America, most large police forces work with academic criminologists. In Britain, research is commissioned by the government, which then launches initiatives and task forces that are deeply resented by the chief constables who run the local forces.

Encouraging local police forces to develop their own methods has often worked where it has been tried. London's police have “ownership” of armed robbery and black-on-black crime, both of which are declining. One way to encourage more fine-tuning of policing to local conditions would be to make crime statistics more readily available. New York's Compstat gives every locality a precise picture of local criminality. That is one transatlantic import well worth copying.

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Technology industry

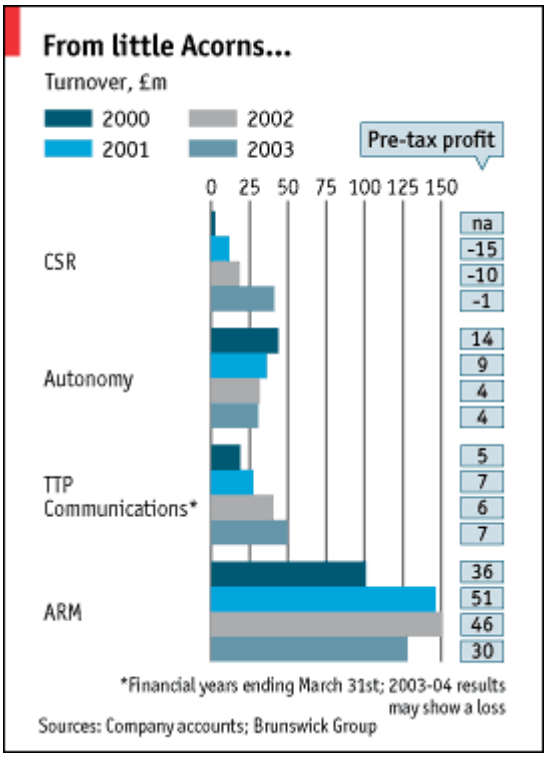
Clustered cloisters

Feb 19th 2004 | CAMBRIDGE
From The Economist print edition

The high-tech industry around Cambridge is hotting up again

NEXT week, Cambridge Silicon Radio (CSR) will go public—the first stockmarket flotation from the high-technology cluster around the university city since late 2000. There'll be no repeat of the high-tech bubble, but Europe's nearest equivalent of Silicon Valley has shaken off the gloom of the bust that followed it.

Cambridge's big success, ARM, a chip designer floated in 1998, briefly had a market value, in early 2000, above £10 billion ($19 billion now); today's is £1.3 billion. Life was crazier still for Autonomy, a maker of information-management software: within days of its launch in late 2000, its shares sold at £41, valuing it at £4.5 billion. Two years later they stood below £1, today near £3—and some analysts think that too high. Reality is back in fashion.



In the city's north-east, the St John's Innovation Centre, home to tiny start-ups, even now houses only 60 or so where it could hold 85. But the nearby Science Park, where bigger firms live, never lost heart. CSR steadily pushed up sales of the Bluetooth (wireless connection) chips it designs there. GlobespanVirata, a broadband-access chip designer born of an Anglo-American merger, lost $637m in 2002, only $50m last year, and turnover is more than double what it was a year ago. Ten miles outside the city, TTPCom, another float from late 2000, went on building turnover and profits from its mobile-phone chips until last spring, when the SARS scare hit its East Asian customers.

Those cases show Cambridge's virtues. These are niche firms, but all strong in their niches: ARM dominates its world market; CSR is a giant in Bluetooth. All sprang from local brains: ARM and the original Virata, for example, from people who had worked in the 1980s on the Acorn BBC computer; CSR spun out of Cambridge Consultants, grand-daddy of the cluster (and sire of another Science Park firm surely heading to market soon, Alphamosaic, whose chips lessen gadgets' battery drain).

Yet tech firms need more than technology and entrepreneurs. They need venture capitalists, managers, specialist lawyers and salesmen, who can understand what the geeks are up to and then manage, finance, protect and sell the result.

That “ecosystem” helps give Silicon Valley its global dominance. Cambridge is far behind. But it is catching up, says a financier with experience in both. Ten years ago the supporting cast was rudimentary. Now it is not. The techies agree: venture capital is “much better”, says one at Cambridge Consultants. Hermann Hauser, the ex-Acorn man seen by many as the originator of the whole cluster, in 1997 helped set up Amadeus, now one of several local VC firms; 3i, Britain's biggest venture-capital outfit, has a big presence.

Networks abound, including a formal one, Cambridge Network, linking the university with business. The university, a source of prestige, recruits and would-be Bill Gateses—less so of research—has run an entrepreneurship centre since 1999.

So all is well, now? Not all. Office rents have crashed since the boom, but housing is scarce and costly. Road and rail links to London are good, not so east-west ones; Heathrow is far off and Stansted no substitute for the many firms whose big customers and opportunities lie in the Far East.

A long-term risk also lies there. The cluster designs chips, but they are made abroad, mostly in Taiwan, while the final products bear names like Samsung or Panasonic, or, increasingly, those of firms in mainland China. That makes sense, surely: sell ideas, not goods. But the Far East too has brilliant brains. The first of what will be 60 or 70 Chinese from mainland companies have just set up in the St John's Innovation Centre: some to network, some looking for suppliers, some for joint ventures, some no doubt for customers, and all learning. Fine: Cambridge needs links and, as Mr Hauser puts it, can't play ostrich. But how to stay ahead? Well, how do they manage now? Ask Tony Milbourn, boss of TTPCom: “We run like hell.”

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Education

Prizes all round

Feb 19th 2004
From The Economist print edition

Everyone wants change in education—but painlessly, please

Get article background

NOBODY would say the current system of educating English teenagers is perfect. There are too many exams of dubious worth. Cheating on coursework is easy and common. A quarter of people aged 16-18 drop out altogether. Employers find that too many of the young people they recruit can't read, count or talk properly. Even the best bit, the A-levels taken at 18, increasingly fail on the one thing they used to do well: preparing people for three-year university courses that teach to a level that takes four or five years in other countries.

So Mike Tomlinson, the former chief schools inspector who published a draft report this week on reform of 14-19 education, had a tricky task. His aim is to make the system broader, more flexible, and more rigorous, stretching the cleverest, while encouraging the least able, giving academic and vocational qualifications equal weight, and ensuring that more people have the skills employers need.

The central proposal is a new diploma, with four levels of difficulty, to be introduced over the next ten years. There would be a central core of practical maths, literacy, communication and computer skills, with credits for out-of-school activities such as work experience, volunteering, art, drama and sport.

Much of the report has been widely welcomed. Very bright students will benefit from more advanced material at the top end of the curriculum. Results from their diploma exams will help universities who are currently struggling with large numbers of applicants all boasting the best possible A-level grades.

Another interesting suggestion is that pupils can take courses when they are ready, rather than at the “right” age. That would help the many children who develop late, or early. The General Certificate of Secondary Education (GCSE) exams normally taken at 16 are far too easy for bright, well-taught children, while revealing little about those who pass with lower grades.

Thirdly, the idea that basic qualifications should mean real competence, of the kind an employer can rely on, rather than notional achievements measured by educational theorists, receives a welcome boost. Mr Tomlinson's report notes, correctly, that passes in maths and English at GCSE are no guarantee that enough has been learnt in these subjects to be useful.

In short, the result could be fewer, more significant exams, taken at the stage in a school career that suits the pupil, rather than administrators. That would leave more time for actual education, which would make a nice change.

But there are big difficulties. One is that after decades of government tinkering, it is hard to muster enthusiasm for yet more changes. On a practical level, it will be hard to decide what contribution out-of-school activities make to the diploma. How do those requiring effort, skill and imagination differ from jazzed-up everyday pursuits?

Thirdly, the new system will demand a lot from schools: teaching a 13-year-old with a talent for maths alongside pupils several years older (and vice versa) is tricky. So will instilling the mandatory skills among disheartened, sulky teenagers who have suffered ten fruitless years at school and are in no mood for more.

Finally, there is the danger of political interference. The exam system already covers up much of the failure in schools, enabling the government to insist that standards are rising. If the new diploma system

is really rigorous, it risks uncovering failings that the government would prefer to keep disguised.

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Public-sector reform

A Whitehall revolution?

Feb 19th 2004
From The Economist print edition

The government wants to shake up the way it works. There's a lot at stake

AFTER its narrow squeaks over foundation hospitals and university tuition fees, the government is understandably keen to show there will be no slackening in the pace of public-sector reform. A report by Sir Peter Gershon, the head of the government's efficiency review, conveniently leaked this week to the *Financial Times*, should help convince some of the sceptics.

Although still in draft form—the report is not due to be published until April—Sir Peter's findings, if fully implemented, would mean a dramatic shake-up for the way the government goes about its business. He estimates that up to £14.5 billion ($28 billion) a year could be found by 2007 through cutting the bureaucracy and streamlining “back office” functions, while a further £5 billion is achievable from productivity savings in education, health and policing. Sir Peter, a former chief operations officer of BAe, a big defence contractor, reckons that 16% can be taken from central government running costs and—to the horror of the biggest civil service union—that 80,000 jobs could go.

Sir Peter is proposing a number of sensible, but nonetheless pretty radical, measures. They include: a revolution in the handling of the government's £120 billion a year procurement bill through the creation of a handful of expert buying agencies; shared services, such as human resources and IT, centralised within clusters of departments; less regulation and monitoring of both public-sector providers and businesses; a one-stop-shop retail network to handle a wide range of government-to-citizen transactions from tax and benefits to grants for free school meals; a single means test covering all entitlement programmes; the use of insurance companies and banks as collecting agencies for taxes and fines; a carrot-and-stick approach to force households with computers to interact with government online.

By chance (hardly), the leaking of the report also coincided with a speech by the shadow chancellor, Oliver Letwin, outlining a future Tory government's spending plans (see article). It is a crucial element of Mr Letwin's argument that the huge increases in spending of recent years have yet to be reflected in the kind of improvements to key public services voters were led to expect. Sir Peter's work, and the government's apparent determination to push ahead with his main recommendations, takes some of the sting out of Conservative charges that Labour has gone soft on reform. But, as Mr Letwin was quick to point out, it also greatly strengthens the Tory case that there is plenty of waste just waiting to be attacked.

This is as far as consensus goes. The government says it wants to use the resources liberated by the efficiency review to be ploughed into “front-line” services. The Tories, on the other hand, would like any savings not needed to reduce borrowing to be used to fund tax cuts. That will be a worthwhile and interesting debate. But the danger is that they may both be tempted to count chickens too soon. Identifying what should and could be done is one thing; actually doing it, quite another.

Sweeping business process change of the kind envisaged by Sir Peter requires both good leadership and consistency of commitment. It is quite a tall order even for a well-run firm with a clear chain of command, strongly incentivised senior managers and employees who are at best co-operative and at worst easy to fire. Trying to do the same thing, but on a much larger scale with transient ministers, risk-averse civil servants and stroppy public-sector unions will be a good deal harder.

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Wales

How different

Feb 19th 2004 | CAERDYDD (CARDIFF)
From The Economist print edition

The new Welsh way of government: more money, less choice

Get article background

IT IS not just the outsize road signs needed to accommodate consonant-rich Welsh-language names. Compared with England, Wales increasingly looks like another country. Education and health already differ noticeably. Now prescription charges are being abolished, free school breakfasts are being introduced and free bus travel for pensioners is on its way. Is socialism, dismantled by Margaret Thatcher and disdained by Tony Blair, being reconstituted under the flag of the red dragon?

The New Labour mantra, of more choice for public-services consumers like parents and patients, is explicitly rejected by the ruling Welsh Labour Party. Rhodri Morgan, the first minister, prefers “Welsh solutions for Welsh problems”. Welsh society is different, he says. “It has a smaller middle class, so community choice will be more relevant than consumer choice.” He speaks of putting “clear, red water” between him and Tony Blair.

The National Assembly for Wales, unlike the Scottish Parliament, cannot legislate or raise taxes. Derided as a toothless talking-shop when it was set up in 1999, it has used to the full its limited powers to tweak the process of government. In education, for example, the school league tables so anxiously perused by English parents have gone, along with the tests sat by English seven-year-olds. Tests at ages 11 and 14 are expected to disappear too. Comprehensive schools, not the specialist outfits favoured by the Westminster government, have pride of place. Local education authorities, rule-bound and government-despised in England, enjoy almost complete freedom in Wales.

Decentralising the health service to 22 district boards matching the principality's 22 local councils should mean better co-ordination with the social services departments they manage. That should stop expensive hospital beds being occupied by patients who would be better looked after in a care home. Free school breakfasts, says Mr Morgan, not only mean starting early with healthy eating, but help children socialise and concentrate better in school.

Innovation in government is one of the big advantages of devolution, and some Welsh approaches are watched with interest in Westminster. “We have a lot to learn from each other,” says Lady Ashton, an education minister who meets her Welsh counterparts regularly.

So far, voters like it. In the constituency elections to the Assembly, Labour rose from 37.6% in 1999 to 40% in 2003. The two seats gained meant Mr Morgan could ditch his Liberal Democrat coalition partners and govern alone.

How well it works is another story. Relative to population, eight times more people wait over six months for a hospital operation than in England. The charge that the assembly is handing power to local bureaucratic elites rather than service users has “some resonance”, says Gareth Rees, a Cardiff University social scientist.

So what? A big difference between Mr Morgan and Mr Blair is that Labour's main opposition in Wales is not the Tories, but the left-wing nationalists of Plaid Cymru. The Welsh public sector is big and powerful: 25% of England's workforce is in public services, 32% in Wales; 28% of English workers are unionised, 40% in Wales. Generosity pays. Austerity doesn't.

Particularly when England meets the cost. Though the Welsh Assembly, unlike its Scottish counterpart, has no tax-raising powers, Gordon Brown's big public spending increases have swelled the Welsh budget

from £7.9 billion to £10.4 billion in its first four years; the next four look set to provide annual rises of around 6%.

All plain sailing then, for the tightly knit, Labour-dominated political “Taffia”? Not quite. Spending plans may outstrip even this generous framework. Mr Morgan disputes that. And he stresses that he has no intention of publicly quarrelling with the men in London. That would negate the growing sense of responsibility that he thinks the Assembly has brought to Wales, replacing the traditional political culture in which all the principality's ills were blamed on the English imperialists.

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Publishing

Overbooked

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Publishers are cutting their lists, but the book market is thriving

AGED 71, Charles Chadwick has bucked a harsh trend: his first published novel, a 300,000 word epic of everyday life, has a top publisher, Faber & Faber. It describes the book as “exceptional”; his editor talks of an English Updike. Mr Chadwick says he is “astonished”.

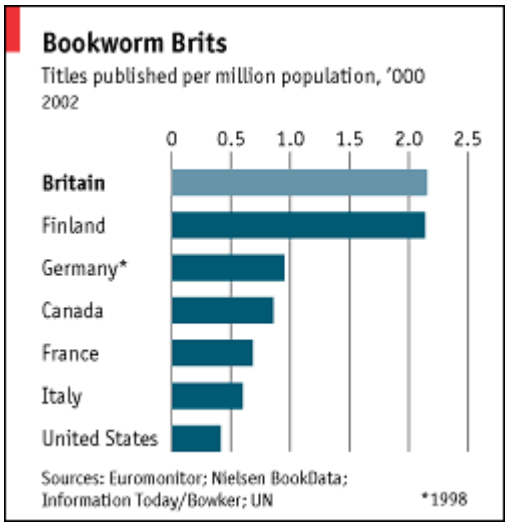
He is right to be. Bookshops want to sell authors who are “media-genic”, meaning attractive, famous or well-established, says David North, managing director of Pan Macmillan, a large publisher. To concentrate resources behind marketable authors, publishers are cutting their lists of new titles. Pan Macmillan has slashed new books by 5% already and it plans a cut of 7% this year and another 10% in 2005. HarperCollins, another giant, has chopped by a fifth over the last three years and plans a similar cut over the next three.

Changes in the bookselling business are largely responsible. After the price controls of the Net Book Agreement collapsed in 1995, supermarkets began shifting best-sellers at discounts. Bookshops, under pressure, consolidated into four big chains. As a result, power has shifted from publishers to retailers, who use their clout to demand extra cash to promote their titles—in three-for-two offers and on shelves near the door.

However distasteful it is to people who like to think of books as something more than consumer goods, flogging them like toys or women's clothing works. Book sales in Britain have risen by 45% in the ten years to 2002, against strong competition from other media such as magazines and DVDs. With price control gone, just over half of all British books are discounted by one retailer or another by anything from 10% up to 50%, which helps volumes. Supermarkets have probably expanded the market. Asda puts books in front of 12m people who come and go through its doors every week, says Toby Bourne, its book buyer. Many of them would not go into a shop that sold only books.

Until the recent cuts, there was little sign that heavily promoted best sellers such as David Beckham's “My Side” were stopping more serious fare from being published. In 2002 publishers sent forth over 125,000 new titles, or nearly double the number in 1990—12,000 of these were fiction, 6,000 were history books and 4,600 were about religion.

Even with the current pruning, Britons will not be deprived of books. They are better catered for than readers in any other big country (see chart). And, says Anthony Cheetham, who founded two independent publishing houses, Century and Orion, there's little chance that a really good book will slip through the net. If big outfits shun commercially risky new authors, smaller houses and the reading public often come to the rescue. Two recent hits—“Life of Pi” by Yann Martel, and “Eats, Shoots and Leaves” by Lynne Truss—were published by small outfits, Canongate Books and Profile Books, and promoted by word of mouth.



The biggest danger, says Mr Cheetham, is that readers miss out on serious non-fiction books because the likes of WH Smith and Books Etc do not promote or discount many of them. Still, high-minded browsers can simply ignore the three-for-two offers and hunt around at the back, or use the internet. For the most part, books are cheaper, more desirable and more accessible than before.

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Labour market

Strikingly soft

Feb 19th 2004
From The Economist print edition

Despite this week's strikes, the labour market is unlikely to overheat

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STRIKES by 85,000 civil servants this week, the biggest for 13 years, have brought back ugly memories. For much of the country's post-war history, union militancy made the labour market work badly. The level of unemployment needed to curb wage inflation rose ever-higher, eventually exceeding 3m in the 1980s.

Yet now fewer than 900,000 people claim unemployment benefit, the lowest since 1975. Whereas in that year wage inflation hit a post-war peak of over 30%, economy-wide average earnings are now rising just 3.4% a year; public-sector pay growth has recently fallen to 4.4% from 5.6% .

The labour market is a bit slacker than it looks. Measuring unemployment by the claimant count is a less accurate guide than the labour-force survey (LFS) estimate of people without jobs who are looking for work. According to that, there are over 1.4m people out of work. The gap between the two measures—the biggest in 20 years—is mainly because the survey includes women job-seekers whose partners' earnings make them ineligible for unemployment benefit. Even so, the 4.9% shown by the LFS is the joint lowest since the series began in 1984.

Furthermore, there are an additional 2.1m economically inactive people who want a job but are not currently looking or available for one. Jobs gained by “inactive” people since 1999 have made a bigger contribution to growth in working-age employment than successful jobfinding by the formally unemployed, according to the Bank of England. More recently, the number of people of pensionable age who are at work has also risen.

The credit for the improvement in the labour market goes partly to the Conservative reforms of the 1980s, which hammered the unions and sharpened incentives to work. The Bank of England's successful squeeze on inflation has also helped to stabilise pay bargaining. So much for the good news.

There are now two difficulties. The first is a rapid burst of economic growth. The Bank is forecasting a rapid economic expansion of nearly 3.5% this year, well above the trend growth rate of 2.5%. That means more demand for labour.

Secondly, although more people are working, the average number of hours worked has been falling for several years. In part, this may be because employers have reduced overtime during the recent economic slowdown. But much of the decline appears to be structural, caused by new rules like the European working-time directive and a greater preference for shorter hours, including part-time jobs. So when demand for labour rises, there will be less slack in the system to meet it.

This week's strikes are probably a blip: multi-year pay deals have settled most of the tricky public-sector pay questions and there is scant sign of wage pressures in the private sector. On balance, therefore, the happy combination of low unemployment and subdued wage inflation looks set to continue. Earnings growth could comfortably recover to 4.5% a year without posing a risk to inflation, says Ben Broadbent, an economist at Goldman Sachs, an investment bank.

A longer-term risk is that increasing employment regulation will gum up the labour market. Like the Conservative reforms of the 1980s, Labour's changes may have a long fuse. But for now the labour market remains comfortingly soggy.

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Bagehot

Beware the charming Mr Letwin

Feb 19th 2004
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Oliver Letwin is not as other politicians. It would be wrong to underestimate him

Get article background

IT WOULD not be true to say that Oliver Letwin strikes fear into the government. The Tory shadow chancellor is just not like that. While his leader, Michael Howard, exudes menace, Mr Letwin is happy to portray himself as a sort of highly intellectual Winnie-the-Pooh. And that is what makes him so dangerous. Ministers know where they are with the ever-combative Mr Howard; brutally effective though he can be, he operates within accepted rules of engagement. Mr Letwin doesn't. The government hasn't quite worked out how to deal with him.

This week, Mr Letwin made a well-trailed and characteristically cerebral speech about a future Conservative government's spending plans. Not surprisingly, these (of which more later) rest heavily on cutting waste and bureaucracy. What better way to spoil Mr Letwin's day, some bright spark not a million miles from Downing Street or the Treasury must have thought, than to leak a few hours earlier details of the government's own plans to reform Whitehall (see article).

Far from being forced on to the back foot, Mr Letwin unreservedly welcomed the efficiency review being carried out by Sir Peter Gershon and took it as evidence that his own proposals were cautious and realistic. It showed, he said in his unfailingly courteous, reasonable tones, that there was actually much shared ground between himself and the government. Surely it was possible to have a civilised, grown-up debate about how best to spend the efficiency dividend? The junior ministers sent out to rip Mr Letwin apart were made to look foolish and clumsy. Their blustering accusation that Mr Letwin was a slash-and-burn destroyer of vital services seemed absurd.

This was quite an achievement. Although some Tory commentators grumbled that Mr Letwin's plans lacked radicalism or any clear commitment to cutting taxes, they can't have been paying attention. Inside Mr Letwin's velvet glove there is plenty of steel. His argument is that the government is not only intent on spending too much, too fast; it is doing so in the wrong way.

Mr Letwin believes that it should be possible to continue with large expenditure increases on health and education, as well as meeting the costs of linking the basic state pension to earnings, while adhering to what he calls a “wiser path” than the chancellor, Gordon Brown. His point of departure with Mr Brown is that Mr Letwin wants to take part of the growth in the economy over a six year period—approximately two per cent of GDP or about £35 billion ($67 billion)— to bear down on borrowing and taxes instead of devoting it to spending.

To accomplish this, Mr Letwin is proposing to get large savings in central-government running costs from a civil-service recruitment freeze and by applying a “corset” to all discretionary departmental spending other than health and education. Defence, transport and the Home Office would get nothing extra for two years, followed by a miserly two per cent growth thereafter. A celebrated business troubleshooter, David James, is working to identify further Gershon-style economies.

The reason for the much higher level of spending on health and education than elsewhere, apart from the obvious electoral one, is that Mr Letwin acknowledges that there will be both transitional and “deadweight” costs in introducing the “passports” (vouchers by any other name) that the Tories believe are the key to opening up competition and choice in the public sector. He is prepared to meet these head-on as the price for removing what he sees as the dead hand of monopoly supply.

For all the right-wing moaning, this is quite ideological and politically risky stuff. Mr Letwin regards Mr

Brown's “golden rule” (the idea that government borrowing over the cycle must not exceed net investment) as far too permissive. At a time when Britain's fiscal position, though deteriorating, is stronger than that of just about any other major economy, Mr Letwin is prepared to impose ferocious spending constraints in areas traditionally favoured by Conservative governments, such as the armed forces, the police, prisons and the roads. In the future, Mr Letwin wants the budget to balance across the cycle, a demanding goal, rarely, if ever, achieved in the post-war period. To that somewhat theoretical end, Mr Letwin readily admits that the scope for tax cuts will be limited for several years. The most he is prepared to promise is that he will avoid the tax increases he claims will ensue from Mr Brown's profligacy.

Softly, softly

The chancellor is convinced that this is not what voters want to hear—at least not yet. In the context of a pretty stable economy that continues to deliver the goods, he thinks there won't be many takers for the hair shirt Mr Letwin is offering. Treasury insiders virtuously insist that none of the Gershon savings will be banked until they're real. But it would be surprising if Mr Brown does not use the results of his comprehensive spending review this summer as a stick with which to beat the Tories.

The chancellor should, however, have a care. As David Blunkett discovered to his huge frustration when Mr Letwin was shadow home secretary, he has a talent for changing the nature of political conversation in unexpected ways. Mr Letwin's exquisite manners, his willingness to concede a point in order to make one and his genuine good humour, lower the defences of political opponents. Sensing that to demonise him is futile, they are lured on to ground of his choosing.

The debate Mr Letwin would like to have with the chancellor is deceptively straightforward. Do tax rises matter? Can the monopoly provision of public services deliver value for money? That is a discussion well worth having, but it is not the one Mr Brown wants to have. Should Mr Letwin succeed—and he just might—he will have done something remarkable. He will have shifted the political game in the Tories' favour.

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India's shining hopes

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REX

After a run of troublesome years, has "India's decade" dawned at last? Simon Long reviews the prospects

ONLY a year ago, India seemed in a sorry state. Tension with Pakistan had recently reached such a pitch that nuclear war did not seem inconceivable. An Indian state, Gujarat, had witnessed appalling communal violence between Hindus and Muslims. The economy, after years of drought, was limping along at an annual growth rate of just 4%, not enough to change the fortunes of a nation of a billion people, a quarter of them living in severe poverty.

One year on, in the phrase of its government's propaganda campaign, "India is shining". The risk of war seems remote and a historic settlement with Pakistan seems possible. Recent state election campaigns have been marked not by communal antagonism, but voters' mature disgruntlement over bad and corrupt government, pot-holed roads, poisonous water and meagre power supplies. The economy, blessed by a lavish monsoon, is growing by 8% a year or more. Hotels are full of foreigners newly alive to India's potential as both a market and an "outsourcing" destination. India fared well in a cricket series in Australia. Indian politicians, businessmen, diplomats and journalists are relishing the new sense of self-confidence. India, said to have been "emerging" for years, has at last come out. This is India's decade, crow the optimists; India's century, echo true patriots.

These are big hopes on the back of a solitary good year, and caution is advisable. After a dozen years of opening up and liberalising, India's economy is still relatively small by global measures. With 17% of the world's people, it accounts for less than 2% of global GDP and 1% of world trade. To take the most obvious comparison, China last year saw an increase in its two-way trade with the world of roughly double India's total trade.

Making electoral hay

Indian exuberance is tinged with the rhetoric of an electoral contest. So good are Indians believed to feel about themselves and their government that the prime minister, Atal Behari Vajpayee, has decided to bring forward the general election due by October to this spring. It is only natural that he should be talking up India's prospects, and that his finance minister, Jaswant Singh, should be sprinkling tax cuts and spending promises as if from a bottomless well.

India is a country of extremes, and prone to extreme views about itself. This survey will examine the

origins of the present buoyant optimism, and conclude that much of it is overdone: or at least, based on hope rather than achievement. Nor was India in quite such a mess a year ago as the pessimists feared. For a decade, the economy had seen average real growth in GDP of about 6% a year. The hope now is that it is about to take off on a markedly steeper growth path of 8% a year or more, and keep it up.

That sort of acceleration is necessary to provide opportunities for India's growing population and its even-faster-growing workforce. During the present decade, on one estimate India's labour force will expand by 50% more than all of East Asia's (including China's) put together. Without further structural reform, such a growth spurt seems unlikely. But this survey will argue that this is indeed a moment of shining economic opportunity for India, and that if Mr Vajpayee's Bharatiya Janata Party (BJP) succeeds in leading its coalition to another election victory, it should be better placed to take advantage of it, and pursue the necessary reform, than has been any government in recent years.

Shining brighter, however, than any GDP growth target is the prospect of some lasting reconciliation with the twin from which India was so bloodily separated at birth in 1947.

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Giving peace a chance

Feb 19th 2004
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Third time lucky?

AP

Into the valley of death

THE partition of India in 1947 left not so much a scar as an open wound, and Kashmir is where it still bleeds. Two of the three full-scale wars between India and Pakistan were fought over the divided territory, which is claimed by both countries. Just under half is controlled by India, most of the rest by Pakistan. For the past 14 years, the Indian-ruled Kashmir valley has resembled a police state. India has been fighting an insurgency waged partly by Pakistan-trained militants. The dispute has thwarted all attempts at building normal relations between the two countries.

The most startling of all the hopes kindled in India at the turn of the year was that all this might be about to change. At a regional summit in Islamabad in January, Mr Vajpayee agreed with Pakistan's president and army chief, Pervez Musharraf, that the two countries should start a “composite dialogue”, which, they hoped, “will lead to the settlement of all bilateral issues”, including Kashmir.

Such a dream, if realised, would bring enormous benefits to both countries. Most important, it would release Kashmir from its misery, ending a war that has killed at least 40,000 people, possibly many more. Even last year—one of supposedly improving relations and relative peace—the violence cost more than 3,000 lives. A blot on India's international reputation would be removed. Pakistan and India could cut defence spending, a big drain on both their budgets. They could stop frightening the rest of the world with the prospect of a nuclear war: both tested nuclear weapons in 1998, and Pakistan has never ruled out being the first to use them. And they could exploit the almost wholly untapped potential for cross-border trade and investment.

The breakthrough in Islamabad followed concessions from both sides. India had always resisted even acknowledging the disputed status of Kashmir, and had demanded that Pakistan dismantle “the infrastructure of terrorism” before any dialogue opens. Pakistan, for its part, gave assurances that it would not allow its territory to be used to “support terrorism in any manner”—a reference to its fuelling of the insurgency. If fulfilled, that promise would mean Pakistan's surrendering what it has seen as its only lever over the fate of Kashmir.

This was the culmination of an initiative launched by Mr Vajpayee in April last year in a speech in Srinagar, the summer capital of the Indian state of Jammu & Kashmir. In a remarkable about-turn, he had offered Pakistan the “hand of friendship”. Ever since terrorists had attacked the Indian parliament in

Delhi in December 2001, and India had accused Pakistan of sponsoring the atrocity, India's hand had been brandished only as a fist. In the course of 2002 the two countries came close to war, with hundreds of thousands of soldiers deployed along the border.

But peace-making has been a consistent theme of Mr Vajpayee's term of office. This was his third (and, he said, final) attempt. The first, in 1999, was scuppered by a Pakistani military adventure in the Kargil area of Kashmir, at a time when General Musharraf had not yet staged the coup that made him president. The second came in 2001, when talks broke down because the two sides refused to make these very same concessions on Kashmir. Undaunted, Mr Vajpayee tried again. He wants to be remembered as a statesman.

He is also, however, an astute politician, and realised that a peace bid would be popular. This was not self-evident. Mr Vajpayee's victory in the most recent general election in 1999 owed much to India's victory in the undeclared Kargil war; in elections in Gujarat in December 2002, his BJP had sailed to victory on a campaign full of vilification of Pakistan. But Mr Vajpayee recognised a national weariness with the constant sparring. Over the summer and autumn of last year, a series of confidence-building measures and of “people-to-people contacts” reminded both countries how much they had in common.

Nevertheless, Mr Vajpayee made his offer from what India saw as a position of strength. A state election in Kashmir in 2002 had, unusually, not been rigged, and although the turnout was low, the new state government, committed to a “healing touch”, had a greater claim to legitimacy than the previous regime. Speaking in Srinagar, the prime minister was reaffirming that this was Indian territory, and would remain so, even if the fighting continued. Debilitating though the war has been, India is a big country and believes that, if necessary, it can fight low-level wars on its periphery indefinitely.

Mr Vajpayee's chief motive in making his friendly overtures was to embarrass Pakistan into reciprocating. Pakistan took its time, but eventually began to respond more enthusiastically to the confidence-building measures, such as the restoration of diplomatic relations and of air, road and rail links, all cut since the attack on parliament. Most significantly, it agreed to discuss the opening of a bus route across the “line of control” that divides Kashmir in the absence of an agreed international border (see map).

In November, Pakistan offered a ceasefire along the line of control. Indian officials believe shooting over the border is often a cover for infiltration by militant fighters. In the winter the snow in the high mountain passes stops most traffic anyway, but India says that this winter hardly any militants are crossing. General Musharraf has even suggested (and his officials have denied) that Pakistan might “set aside” its insistence on the implementation of a United Nations resolution calling for a plebiscite in Kashmir on its future.

Musharraf's gamble

General Musharraf is constrained by popular opinion. Pakistan's Islamist parties, for some of which *jihad* in Kashmir is a sacred national quest, have been buoyed by a tide of anti-Americanism since the much-resented war in Afghanistan in 2001. The militants also have sympathisers in General Musharraf's own army and intelligence services. Having already taken the risk of backing America in Afghanistan against Pakistan's former allies, to renounce the claim on Kashmir would be suicidal—politically, and perhaps

literally as well. In December 2003 General Musharraf narrowly escaped two assassination attempts.

He was also, however, under discreet international pressure from his most important foreign backers—America and China—to prove himself a responsible international citizen. That pressure intensified following revelations that linked Pakistani scientists to nuclear proliferation in North Korea, Iran and Libya. General Musharraf may also see Mr Vajpayee, who is 79, as the only Indian statesman capable of crafting a deal that both allows Pakistan some dignity and placates nationalist hardliners in the BJP. The assassination attempts demonstrated the futility of trying to reconcile the international "war against terrorism" with clandestine support for *jihadis* in Kashmir.

The would-be assassins seem also to have persuaded Indian officials that General Musharraf represents their best hope of a deal. Since the Kargil war, India has never trusted him, but it now believes that were he killed, whoever replaces him is likely to be less accommodating.

So the chances of progress, if not of a resolution, look better than they have done for years. In January, parallel talks opened between the Indian government and the more moderate of Kashmir's separatist leaders. But Indian and Pakistani leaders have been here before. Peace is vulnerable to atrocities by extremists on both sides: a stepping up of infiltration when the snows melt; a Pakistani-sponsored terrorist attack elsewhere in India; or another pogrom directed at India's Muslim minority, like that in Gujarat in March 2002. The process could also be disrupted if assassination, infirmity or an election removes either General Musharraf or Mr Vajpayee from the scene.

Agreeing to talk, moreover, is no more than that. Old habits of thought will be hard to change. Many Indians believe that, sooner or later, Pakistan's soldiers or spies will intervene to thwart peace. Similarly, many Pakistanis believe India wants nothing short of their country's national annihilation. The cynical view is that Mr Vajpayee has bought himself a few months in which he can win an election as a peacemaker, confident that, if his fling with General Musharraf ends in tears, no one will blame him anyway.

In many Indian eyes, a solution to the Kashmir tangle is straightforward: India would drop its claim to Pakistani-occupied Kashmir; Pakistan would do the same for the Indian part; the line of control would gradually become an international border; and India would grant Kashmir greater autonomy. This would deny self-determination to Kashmiris, many of whom want independence from both Pakistan and India. But it would meet India's requirement that no separatist precedent be set for other restive regions, and that its one state with a Muslim majority remain in the Union.

However, such a deal, requiring India to give up only what it does not have, has in the past always foundered on the rock of Pakistani Islamic nationalism. The difficulty will be to keep Kashmir on the agenda, as Pakistan insists, without confronting the hardest issues until a real constituency for peace has been built in both countries.

Coming out

In the cavernous corridors of Delhi's South Block, housing the foreign ministry, Indian diplomats are on a roll. Besides progress towards peace with Pakistan, they are cheering moves towards regional integration and advances in their other two most important bilateral relationships, with America and China.

The breakthrough with Pakistan came at a meeting of the South Asian Association for Regional Co-operation (SAARC), a body rendered largely useless by the unremitting hostility between its two biggest economies. This time, however, it did agree to establish a regional free-trade area from 2006, and Mr Vajpayee is even speaking dreamily about open regional borders, economic union and a single currency, on the model of the European Union. That seems far-fetched. A more modest ambition, however, of a network of co-operative arrangements that raise the price of war, sounds achievable.

The dreadful punctuation mark left by the September 11th attacks on America interrupted one of the unfolding stories of the post-cold-war world: a gradual shift in American allegiance from one Asian giant—communist, dictatorial, mercantilist China—to another—democratic, liberal, economically unthreatening India. In late 2001, America, to India's bewilderment, found itself locked in an embrace with Pakistan. Yashwant Sinha, India's foreign minister, says India never asks the United States to exert pressure, but that "if there is a state which is sponsoring terrorism, then the world has a responsibility to the state which is a victim."

Relations were complicated further when India refused to send soldiers to Iraq. In a country where traditions of anti-imperialism, third-world solidarity and non-violence run deep, the refusal was less surprising than the voices in the BJP arguing for Indian participation, seeing a chance to make common cause with the superpower against terrorist Muslims. On other issues, India has already shown a pragmatic willingness to pursue its perceived national interest at the expense of its “traditional” values. Its support for Tibet, for example, whose spiritual leader, the Dalai Lama, has been in exile in India since 1959, has become weaker as relations with China have become more important. And India maintains good links with the generals in Myanmar who throttled the country's democratic movement.

Despite differences over Iraq and Pakistan, however, relations with America are probably, as Mr Sinha boasts, better than ever. Sanctions imposed on India after its nuclear test have been lifted; in January a long-awaited agreement was reached on trade in “dual-use” technologies (ie, with a military as well as a civilian application); and co-operation on civilian nuclear technologies, space and missile defence was hailed as taking “strategic partnership” to new heights. Similarly, last year saw big strides towards improving the prickly relations with China, which humiliated India in a border war in 1962. Long-running talks on the huge territorial dispute have for the first time gained serious momentum.

“The India that can't say yes”, a phrase used by Stephen Cohen, an American academic, sums up the difficulties foreigners have had in dealing with the place. But now it is recognised, says Mr Sinha, with some justification, as a leading nation on all fronts. As in its early days of independence, India is “ready once again to engage with the world”. He is optimistic that support is growing for one cherished Indian ambition: a permanent seat on the United Nations Security Council. India, long condescended to as an “inefficient democracy”, is now earning credit for its achievements and is ready to “cash the democracy dividend”.

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Battle on the home front

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From The Economist print edition

The wonder that is Indian democracy, and its enemies

Reuters

Vajpayee: the hands of history?

ENTERING India from Pakistan at the Wagah border, in Punjab—the only way across in the absence of direct air links until this January—is a tedious business. A sleepy Pakistani official reads passports in a leisurely way; the customs man searches bags perfunctorily and pesters travellers with offers to change money; porters fight over luggage; a policeman writes names in a big ledger. Then, as if to celebrate an escape from this petty harassment, a big billboard comes into sight: “India, the world's largest democracy, welcomes you.”

For all the democratic gloss General Musharraf has given his government, it still has a claim to being the world's largest military dictatorship. But the Indian slogan is more than a typical exercise in bilateral point-scoring. India's justified pride in its democratic credentials is an essential part of its international image.

In a federal system with 28 states, it is election season in India most of the time. The season is now at its peak. Mr Vajpayee has announced that he wants to bring forward the general election that, constitutionally, has to be held by October, and hopes to be forming a new government by April. It is, potentially, a decisive moment for India. Mr Vajpayee's “National Democratic Alliance” (NDA), a coalition of a score of parties, dominated by the BJP, has been in power since 1998, and looks well placed to win another five-year term. For the opposition Congress Party, which led India to independence and ran it for nearly the next 50 years, that has life-threatening implications.

The election campaign in truth started last year, directed initially at four state polls held on December 1st in which the BJP did well. It regained control of three Congress-held states—Rajasthan, Madhya Pradesh and Chhattisgarh—all in the Hindi-speaking belt of northern India, where half of India's people live and general elections are won or lost. Following this success, Mr Vajpayee faced increasing pressure from his party to cash in on the national “feelgood factor”.

Dynasty

Mr Vajpayee was candid in one explanation he offered for holding an early poll: “The opposition is in disarray.” Congress is, indeed, in a pickle: there have been bitter intra-party feuds in a number of states, including Kerala in the south and Punjab; and its efforts at finding coalition partners have appeared haphazard and rather desperate. All of this fuels criticism of its Italian-born leader, Sonia Gandhi, the widow of Rajiv Gandhi, a former Indian prime minister assassinated by Sri Lankan Tamil terrorists in 1991.

To the outsider, it seems incredible that Congress, India's oldest and proudest political party, can find no better leader. The BJP will sneer at her foreign origins, though many ordinary voters seem not to mind. More important, despite improving as a public speaker and political operator over the years, she still seems to have little natural appetite or aptitude for the fray.

Part of the BJP's campaign strategy is to turn the election into a prime-ministerial contest. Mr Vajpayee's stature, for now, is greater than that of any other Indian politician. The opposition has no one to match him, even were Mrs Gandhi to make way for another candidate. She owes her position to a dynastic succession in the family of Jawarhalal Nehru, India's first prime minister, and father of the third, Indira

Gandhi, Rajiv's mother. Sonia's daughter, Priyanka, 33, is next in line. Her Indian birth makes her a better long-term bet.

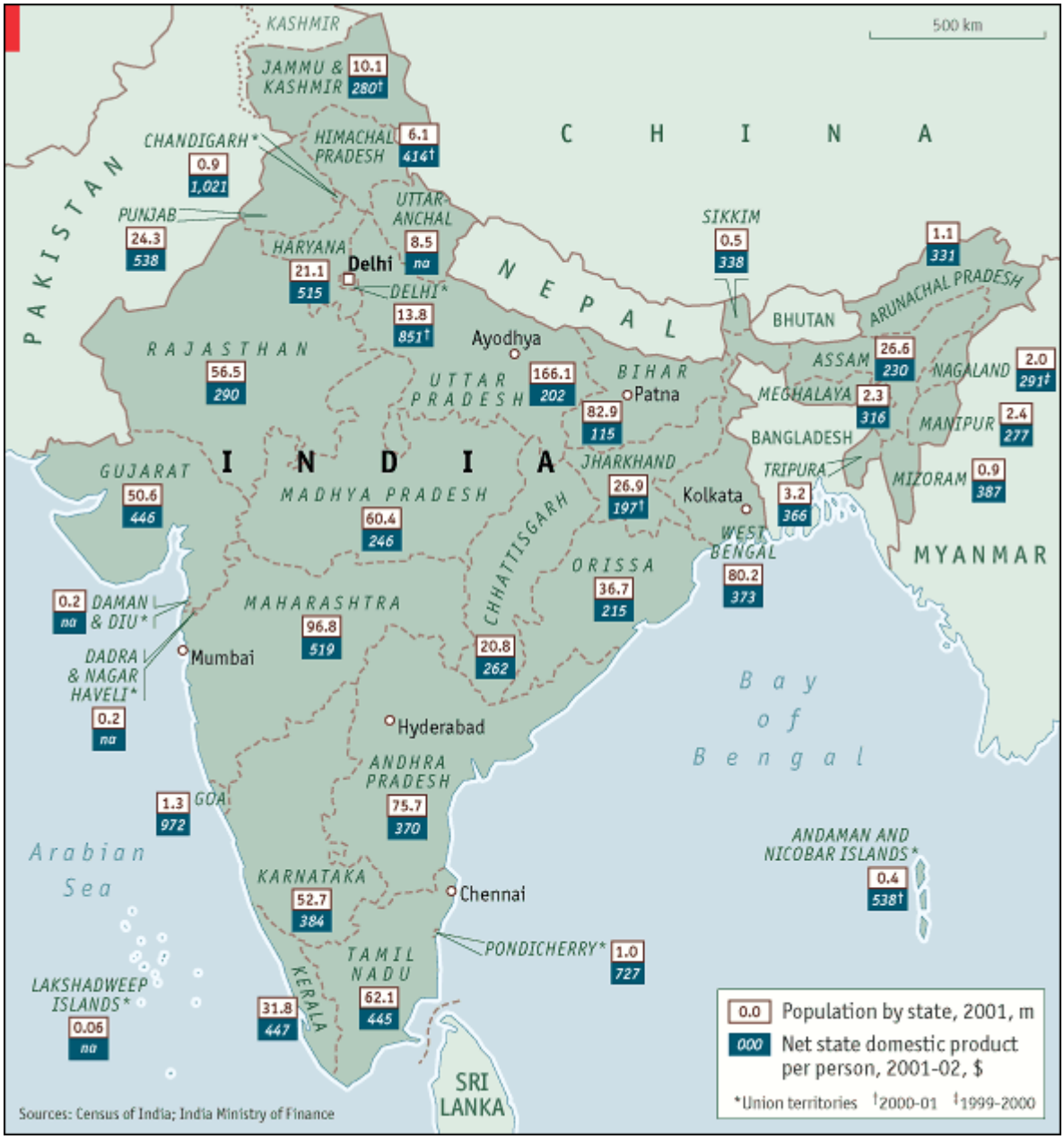
That is, if Congress has a long term. Its leader is not its only handicap. The growth of regional and caste-based parties means that coalition governments seem inevitable for years to come, and compared with the BJP, Congress is an inept coalition-builder—partly because of its arrogance, but also because it is far more of a national party than is the BJP. Often it is one of the two main parties in a state, making it hard to form local alliances.

So Congress's efforts to form a common front with other parties against the BJP were at first fraught. Left-wing parties such as the Communists, who still run the state of West Bengal, at first preferred to stick with ideological soul-mates. Congress also endured the humiliation of seeking an alliance with the Dravida Munnetra Kazhagam (DMK), an opposition party in Tamil Nadu, a big southern state, which it had long shunned for its alleged support for the Tamil Tigers, Rajiv Gandhi's murderers. This heightened the impression that Congress has few principles left.

The party presents itself as the defender of the Nehruvian legacy of secularism against the Hindu-fundamentalist aims of the BJP. Yet it tempers this message when expedient, and it lacks a clear economic policy. The reform process was started by a Congress government in 1991, yet now the party, seeking the votes of the poor, often finds itself taking up populist anti-reform causes.

Wild about saffron

The NDA's reformist credentials are questionable too. The BJP itself, in fact, is at least two parties existing side by side. One is a party of right-of-centre economic liberals, the other is the political wing of a mass social movement called the Rashtriya Swayamsevak Sangh (RSS), or Association of National Volunteers, parent of a family of Hindu organisations including the Vishwa Hindu Parishad (VHP) or World Hindu Council.



This BJP has a specific set of policies based on *hindutva*, or Hinduness. The party rose to national prominence in the early 1990s, on the back of a campaign to rebuild a temple to the god Ram in the town of Ayodhya in Uttar Pradesh. Its supporters claimed the temple had been demolished by Muslim invaders in the 16th century and replaced by a mosque. The campaign culminated in a riot in which the mosque was torn down in December 1992. Terrible communal violence between Hindus and Muslims ensued.

The temple remains unbuilt, however. The RSS and the BJP both insist they are committed to its construction. However, to attract allies, the BJP agreed to leave the issue to the courts, where cases drag on interminably. Similarly, it has not pursued other *hindutva* issues, such as the demands for a uniform civil code to supplant the family law applied to Muslims, and the revocation of Kashmir's special status. It has, however, used more subtle ways of painting India saffron, the Hindu holy-man's favourite colour, such as rewriting school history books.

The Gujarat election in December 2002 was a triumph for a BJP following a hardline *hindutva* campaign. But in the four state elections held a year later, the BJP concentrated on the failings of the incumbent Congress governments. The results were hailed as a vindication of Indian political maturity.

This is a bit of a stretch. First, it tells only part of the story of the state elections. They were really a victory for the professionalism of the BJP machine, which relies heavily on RSS grass-roots work. Second, “anti-incumbency” is always a big factor in Indian elections. The RSS until late last year was saying that it would create a climate where every election candidate had to set out his position on the Ayodhya temple. But it is now talking of the possibility of a negotiated settlement, following a surprising offer to mediate by the Dalai Lama. Ram Madhav, the RSS's spokesman, admits rather sheepishly that the

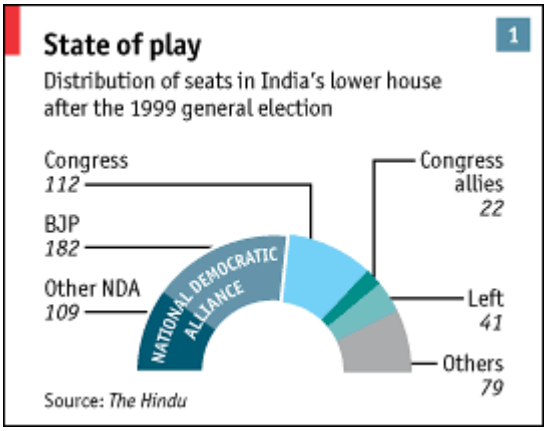
hindutva demands are not central election issues.

Few doubt, however, that the BJP and the RSS would revive them if they looked like vote-winners. The BJP has not, for example, disciplined Narendra Modi, its chief minister in Gujarat, despite compelling evidence that his government connived in the violence in March 2002, in which as many as 2,000 Muslims were murdered. Some suspect that, if the BJP returns to power with more seats, it might step up the pace of "saffronisation".

Sunil Khilnani, of the School of Advanced International Studies in Washington, DC, argues that the BJP is still committed to a "redrawing of what India is", including changing the secular constitution. This naturally unsettles minorities, especially Muslims, who make up about 12% of India's population. But it also worries Hindu liberals, who detect an intolerant, xenophobic strain in BJP thought. They point to new restrictions making it harder for Indian non-governmental organisations to receive foreign donations, and new approval procedures for academic conferences on "political" subjects. There is also a strain of economic nationalism in the BJP which sits uneasily with the reformists' embrace of globalisation.

Mr Vajpayee has been adept at holding all these threads together. It is sometimes suggested that without him the NDA might collapse, such is the esteem he enjoys at the moment. BJP rule relies on a motley group of allies. They include Shiv Sena, a right-wing Hindu fundamentalist party with its roots in Mumbai; Samata, a left-wing party strong in Bihar; and the Telugu Desam Party (TDP), a language-based party from Andhra Pradesh known for the modernising zeal of the state's chief minister, Chandrababu Naidu.

Until recently, it had been assumed that Mr Vajpayee might quite soon hand the BJP's reins to his deputy, Lal Krishna Advani, who has been famous as a hardliner ever since he led the Ayodhya campaign in the early 1990s. But the prime minister's recent vigour suggests he hopes to serve another full term, and Mr Advani is also in his mid-70s. So the leadership may eventually pass to a younger generation. Some of the most prominent of these—such as Mr Modi and Arun Jaitley, the law and commerce minister—are both economic liberals and RSS graduates.



Some NDA members and outside supporters, such as the TDP, might find a hardliner difficult to accept as prime minister. But they would probably find it even harder to leave government. Some still hanker, however, after a "third-force" government of smaller parties, and an NDA victory is by no means a foregone conclusion. The anti-incumbency vote is not as big in national as in state elections, but the present glow might not erase all memories of what, on average, has been a relatively poor economic performance over the past five years.

In a number of big states where the NDA did well in the general elections in 1999, it will find it hard to do better. In the biggest state of all, Uttar Pradesh, which has 80 seats (25 of them BJP-held) out of the 545 in the *lok sabha*, or national parliament, it seems to be relying on the hope of working with the Samajwadi Party after the election. That party currently runs the state government, but its avowedly socialist heritage and its partly Muslim support base preclude a formal alliance. In the south, the BJP's presence is still modest.

The rise of small parties with solid "vote banks" in limited geographic, linguistic or caste groups is dispiriting for those hoping for a government with a broad national reformist mandate. So is the quality of elected leadership. J.M. Lyngdoh, until this month head of the independent Election Commission, last year described Indian politicians as a "cancer", and said none of them had the greater public good at heart.

Not shepherds but crooks

His gloom resulted from the difficulty of holding free and fair elections. Ruling parties shamelessly bribe voters with, for example, free electricity. In office, politicians switch allegiances as quickly as you can say, "Join the cabinet". A new law tightens anti-defection provisions further and, perhaps more usefully, limits the number of ministers a state government can have. At the local level political power is grabbed by strongmen and criminals, and the route to elected office is routinely described as through "money and

muscle". This can happen anywhere, not just in the wild countryside. Of 70 members of the local legislative assembly in Delhi, 26 face criminal investigation, mostly for "rioting".

These details are known because Election Commission rules now require candidates for office to reveal their educational background and criminal record. Along with a free press and an activist Supreme Court, the commission is one of a number of stubbornly independent unelected institutions that help to protect Indian democracy from the elected politicians.

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Looking on the bright side

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India's economy is revving up

Magnum

It's raining higher growth rates

AS 2004 began, there was no shortage of good economic news. In the third quarter of 2003, GDP grew at an annual rate of 8.4%. The full benefits of the abundant summer monsoon, including a big boost to demand from the 70% of Indians who live in the countryside, had yet to show up in the figures, so for the whole fiscal year, ending in March, growth of more than 8% seemed well within reach.

In the meantime, other indicators glowed with health. Foreign-exchange reserves stood at record levels of more than $100 billion; the stockmarket had recorded its biggest annual rise in 12 years; inflation and interest rates were low; the current account was in balance. Externally, the global economy was on an upswing; China next door was booming, and for once this was seen as an opportunity rather than a threat; and the globalisation of services in international business played to India's strengths.

Unsurprisingly, India's finance minister, Jaswant Singh, says that the fundamentals of the Indian economy are better than ever before. In a series of recent announcements, including an interim budget, Mr Singh offered a variety of sops to different groups of voters: cuts in customs and excise duties likely to appeal to the urban middle classes, pay rises for civil servants, new high-interest savings schemes for the elderly, and so on.

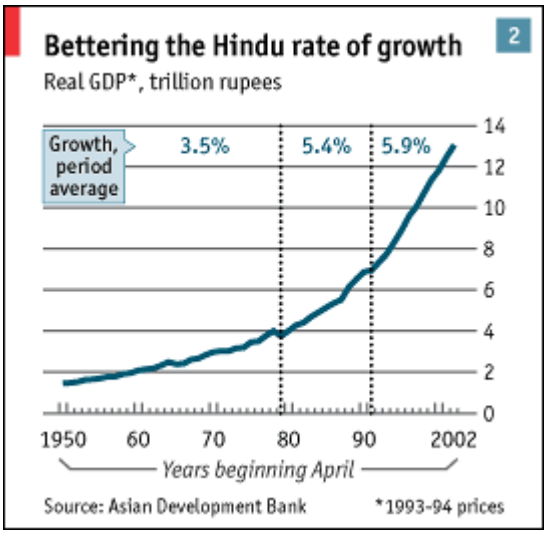
Mr Singh's optimism is widely shared in India. Much attention was given to a forecast published last October by Goldman Sachs, an American investment bank, for Brazil, Russia, India and China, four large developing economies. It predicted that, over the next half-century, growth will slow sharply in the world's six big rich countries and in Brazil, Russia and China, but that India will continue to average annual growth of more than 5%. By 2032 its GDP will be bigger than Japan's, and by 2050 its national income per head in dollar terms will have multiplied 35-fold.

Certainly, the long-term growth trend is improving. The past three decades have seen a steady acceleration. Average annual growth in GDP per head climbed from 1.2% in the 1970s to 3% in the 1980s and 3.9% in the 1990s. If that rate is maintained, GDP per person will double in only 18 years.

From 1972 to 1982, GDP growth averaged 3.5% a year—the so-called “Hindu rate of growth”. The economy was still held back by the socialist system Nehru had built in the 1950s, and by the elaborate “licence raj” the Indian bureaucracy had constructed to regulate it. That performance may now look lacklustre compared with that of the East Asian tigers, but at the time it seemed quite respectable. Adjusted for purchasing power, China's GDP per head did not overtake India's until 1991.

From 1982 to 1992, after Rajiv Gandhi began stealthily to liberalise the economy, GDP growth climbed to an average of 5.2% a year. A national solvency crisis in 1991 prompted far-reaching if incomplete reforms: slashing import tariffs, selling some government-owned businesses, and easing licensing restrictions on what businesses could make. From 1992 to 2002 the growth rate climbed to 6%.

India's current five-year plan, the tenth (reform has by no means done away with all vestiges of socialism), began in April 2002 and aims at a further increase in the annual average growth rate, to 8%, the minimum needed to provide jobs for a growing population. After a poor year in 2002-03, when the economy grew by just 4%, that figure has slipped beyond reach. But the latest spurt has encouraged hopes that the shortfall might not be large.



The most fundamental long-term reason for optimism is demographic. More than half of all Indians are under 25 years of age. It is the sort of bulge in the numbers of people in productive age groups that produced explosive growth in China and South-East Asia. When Indira Gandhi briefly imposed dictatorship on India, the so-called emergency in 1975-77, her government coerced people into having fewer children. Once the emergency was lifted, the birth rate rocketed, but has since come down again. Meanwhile the baby-boomer generation has emerged into adulthood, boosting the share of working-age people.

According to the 2001 census, India's population was growing at a rate of around 2% a year in the previous decade, a marked decline on earlier decades but still adding 181m people, more than the total population of Brazil. The reason India is expected to outperform Brazil, Russia and China as well as the rich world in the Goldman Sachs forecasts is that it is the only country where the population will continue to grow for the next 50 years and where the proportion of working-age people will increase well into the 2020s.

Such projections, however, are not the main reason for the smiles worn by Indian businessmen. M.S. Banga, the chairman of Hindustan Lever, a subsidiary of Unilever and India's largest consumer-products firm, has a succinct diagnosis: “Rain and pain.” That neatly sums up the exceptionally good monsoon experienced in most of India in 2003 and the benefits of restructuring at Indian firms.

Heaven-sent

Last summer's rains, the best for at least five years, followed an especially severe drought in much of the country in 2002. Agriculture still accounts for nearly a quarter of Indian GDP. Most of the difference in the growth rates between 2002-03 and 2003-04 will come from the turnaround in agricultural production, from a decline of 5.2% to an increase of 9% or more. This refreshes the entire economy, keeping inflationary pressures in check and putting money in the pockets of farmers to spend on consumer goods and houses, boosting those industries as well.

The pain Mr Banga refers to has been caused by three sets of pressures: a sluggish domestic economy; a bout of over-investment in the mid-1990s leading to excess capacity; and the greater exposure to international competition that followed the reforms of the early 1990s. Indian firms have since become leaner and more efficient, capable of competing with the best in the world. Y. Venugopal Reddy, governor of the Reserve Bank, India's central bank, points to industry's productivity gains since the mid-1990s as evidence that the “structural component of the present growth is bigger than the cyclical”.

The strength is broadly based. It includes pharmaceuticals, where the prowess of firms such as Ranbaxy, Dr Reddys and Cipla in producing generic versions of off-patent drugs has turned them into exporting successes. But it also covers industries such as carmaking and, especially, the car-parts business, as well as old-fashioned commodities such as steel, cement and aluminium. B. Muthuraman, managing director of Tata Steel, says his company is the lowest-cost producer in the world. Similarly, Anil Singhvi of Gujarat Ambuja Cements explains that India is the cheapest place to build a cement plant.

Indian business has enjoyed a sharp fall in the cost of capital.
The decline in global interest rates and stable, low inflation at

home have enabled the Reserve Bank to cut its benchmark rate from 12% in 1997 to 6% by the end of 2003. This has encouraged a borrowing binge among consumers, especially to buy houses (mortgage finance is growing by about 30% a year) and cars (sales in December were up 37% on the same month in 2002).

The fall in interest rates has come as the currency, the rupee, has broken with its traditional steady depreciation against the dollar. Instead, since the middle of 2002, the rupee has been strengthening, to the consternation of exporters. It would have risen further had the Reserve Bank not intervened. This has caused a rapid build-up of foreign-exchange reserves, creating new sorts of problems. The bank has begun to worry that it might run out of the government securities it sells to "sterilise" the inflows. But in a country which saw reserves shrink to around $1 billion in 1991, their swelling is viewed with pride.

Among the many reasons for the surge in reserves has been the success of an industry which has become another source of Indian pride: information-technology and remote-services businesses.

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The remote future

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A global trend converges in India

“I WANT to change the way the world does business,” says Joseph Sigelman, one of the two American founders and bosses of OfficeTiger, a burgeoning outfit in Chennai (formerly Madras). That seems a hubristic ambition in an otherwise modest young man, but Mr Sigelman and others like him are well on their way to achieving it. OfficeTiger is a back office for hire, performing a variety of number-crunching, data-processing, research and analytical chores for clients on the other side of the world, including blue-chip investment banks, accountants and law firms. In 2003, its head count increased from around 600 to 1,500, an expansion mirrored in many other India-based “outsourcing” firms. Vivek Paul, of Wipro, a big Bangalore-based information-technology firm, says that for most of 2003, his company was adding staff at the rate of 1,000 a month, two-thirds of them in “business process outsourcing” (BPO).

Nandan Nilekani, boss of Infosys, Wipro's great local rival, explains: “The globalisation of white-collar services has become mainstream.” This process, which took decades to transform manufacturers' supply chains, is accelerating as it reaches the desktop. India, with its wealth of well-educated English-speaking young people commanding, by rich-world standards, very low wages, is at the hub. “Every company aspiring to be global”, says Mr Nilekani, “has to have an India strategy.”

Many are still developing one, which is the first of several reasons why the present mood of optimism about the industry's growth prospects seems justified. According to a survey in December by Morgan Stanley, an investment bank, of chief information officers at big American firms, only 14% were engaged in BPO, a proportion the survey says may double in 2004.

Second, the range of work being performed remotely is constantly expanding. The most publicised parts of the outsourcing boom involve two very different activities: writing computer software code and answering the telephone in call-centres. But the applications are almost endless: transcription of medical records or even remote diagnosis; desktop publishing; filing tax returns; processing insurance claims; updating annual audits; preparing presentations; market research; engineering design work; and so on and on. Jerry Rao, boss of MphasiS, a software and outsourcing firm with operations in Bangalore and Mumbai, says it is like “peeling an onion” as firms begin to question if they need to keep in-house any process “you don't need to taste, feel, smell or touch”.

Third, much of the global market remains untapped. According to Mr Rao, who is also the next chairman of Nasscom, the Indian IT-industry lobby, some 85% of its members' revenues derive from America and Britain. More firms elsewhere will be seeking similar cost advantages.

At least four sorts of companies are scrambling to win their share of the growing outsourcing cake. There are the Indian software firms, such as Tata Consultancy Services, Infosys and Wipro. Such firms now aspire to be “full-service” providers to their clients, able to take on everything from writing software applications to managing the payroll. Then there are specialist third-party outsourcing firms such as OfficeTiger, Evalueserve, or the bigger Cognizant, Daksh, EXL and WNS, once a unit of British Airways. Bigger still are some of the captive units set up by multinationals, especially financial firms, such as GE Capital, American Express, HSBC, Citigroup and Standard Chartered. Lastly, there are the giant global professional-services consultancies, such as IBM, Ernst & Young and Accenture, taking on upstart competitors such as Infosys and Wipro by offering services in their own backyard.

No boom is unstoppable or everlasting, and a thinning of the ranks of the hundreds of new BPO firms is inevitable. There is a limit to how much even the most zealously cost-cutting firms are willing to outsource, and India's BPO industry faces a number of dangers: protectionism in its most important markets; over-reaching itself; third-country competition; and

government meddling.

Worries about a protectionist backlash in America are likely to mount in an election year there. Whereas much of the world is used to the idea that cuddly toys come from southern China, the idea that a telephone call about something local—a gas bill, say, or a railway timetable—should be answered locally is still deep-rooted.

America's federal government and a number of its states have started to pass laws to restrict their governments' ability to award contracts to foreign firms. Nasscom's president, Kiran Karnik, says that the concern is not so much the threat of government legislation as the climate of resistance to outsourcing that this fosters. Yet if every American state were to bar official contracts with foreign firms, only 2-3% of Indian firms' business would be affected.

In Britain, in particular, a number of trade unions have expressed fears about job losses because of outsourcing. The sensitivities are now such that many firms are coy about their Indian links. Rohit Kapoor, president of EXL, says his firm has put a lot of work into bidding for a contract from "a developed-country bank" which will not even identify itself until it has made its choice.

A call-centre too far?

There have recently been a few reports of "insourcing"—of western firms taking back services previously outsourced to India. Both the two most publicised cases—Dell, a computer firm, and Lehman Brothers, an investment bank—involved call-centre help-desks and affected only part of their Indian operations.

A disgruntled Pakistani remote worker who threatened to circulate medical records on the internet revived another fear, about confidentiality. All this points to an even bigger worry, that the quality of service will suffer in the rush to expand capacity. Staff turnover in call-centres is running at 35-40% a year even at some of the top firms, and more at lesser employers.

Mr Karnik argues that for the next decade at least, the supply of English-speaking BPO workers is unlikely to be a constraint. Mukesh Ambani, chairman of Reliance, India's largest private-sector firm, estimates the "professional resource base" for the industry is about 7m-7.5m people, growing by 700,000-800,000 a year. Certainly, most BPO firms claim they are spoiled for choice. But competition for the best-qualified people is intense.

Wage rates are also showing a healthy rise—of about 10% a year, on some estimates—which is denting the fat margins that firms have become used to. There are other cost pressures too: the appreciation of the rupee against the dollar over the past two years; and the inadequacy of Indian infrastructure. This is such that most firms provide their own back-up electricity supplies and telecommunications links, and even full-scale bus-services to compensate for the failings of the public-transport system. "At some point," says Wipro's Mr Paul, "it would be better if we didn't have to do it all ourselves."

That point would come if India's share of this market came under threat from elsewhere. The two biggest worries are the Philippines, with its high literacy rates and large number of English-speakers, and in the longer term China, with its huge and growing clout in the global marketplace.

The Indian government, of course, is capable of finding other ways of spoiling the party. The Indian IT industry has suffered from the government's failure to build decent roads and airports, but otherwise has shown what India can do when basking in official neglect, freed from the shackles of the "licence raj". "We benefit not from what regulations the government creates", says Mr Paul, "but from the regulations it removes". Yet there will always be a temptation to meddle.

For the time being, however, there seems little reason to doubt some of the rosy forecasts for the industry's growth. Mr Karnik stands by one produced in 1999, and reaffirmed two years ago by Nasscom and McKinsey, a consultancy, that revenues from India's IT and "IT-enabled services" can expand at a compound annual rate of 34% until 2008, by which time they will total $77 billion and contribute 30% of the country's foreign-exchange earnings.

The effect of all this on India as a whole might, however, be limited. Remarkably, during the 1990s, industry actually shrank as a proportion of the Indian economy. Services now account for more than half of GDP (see chart 5). But this does not mean that tens of millions of Indians are working at computer terminals. The Nasscom forecast for 2008 is that the industry will directly employ 2m people, up from an estimated 770,000 now, and create another 2m jobs indirectly.

Two million jobs are no more than a drop in India's 470m labour pool, joined each year by more than 9m new entrants. Also, they will be concentrated in just a few parts of the country. With some exceptions, most IT and BPO outfits are clustered: in Noida and Gurgaon, suburbs of Delhi, Mumbai and Pune in Maharashtra, and in Bangalore, Hyderabad and Chennai. Other cities, such as Kolkata (Calcutta), are struggling to stake their claims.

In China, economic reform and growth led to millions of people leaving the land to work in factories. In India, growth has been largely jobless. Industry has become more productive and competitive, but without taking on huge numbers of people. Most Indians work on the land, or in what is euphemistically called “the unorganised service sector”. One of the fastest-growing occupations is that of security guard. As Subir Gokarn, chief economist of Crisil, a credit-rating agency, points out, such jobs offer no prospects of “income mobility” over a lifetime.

On the outskirts of Bangalore, firms such as Wipro and Infosys have built serene, orderly, clean, state-of-the-art campuses as modern and efficient as anything in Silicon Valley. Such places are plonked, incongruously, in the middle of India, connected only tenuously with the surrounding confusion and poverty. The challenge is to broaden and deepen those connections in a way that spreads the enormous benefits remote-services businesses are bringing India without damaging their ability to compete globally. “We have created an engine,” says Mr Nilekani. “We need to use it to pull the train.”

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The flip side

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Too little investment; too big a deficit; too few jobs

INDIANS' mood swings about their economic prospects have an “eerie cyclicality” about them, says Suman Bery, head of the National Council for Applied Economic Research, a Delhi think-tank. Glee follows dismay with only the most fleeting halt at guarded optimism. Even now, most of the apparent good news can, to the gloomy, seem reason to worry: the bulging workforce becomes a looming unemployment crisis; the booming IT industry, a dangerously isolated enclave; even subdued inflation and interest rates, signals of weak demand and a lack of investment.

With a soaring stockmarket, low interest rates and a surfeit of animal spirits, you would expect India to be enjoying an investment boom. It is not. There is some evidence that one might be in the offing. By the end of last year, manufacturing industry was adding fixed assets at a rate of 8.5% a year. The Reserve Bank's Mr Reddy points to increased demand for bank loans; imports of capital goods have also been rising. The Confederation of Indian Industry (CII), a business lobby, says that about 150 manufacturing companies have announced new investment projects, in addition to an expected investment of $7 billion in telecommunications and $2.5 billion in road-building.

However, concerns about the pace of capital spending and about access to credit for enterprises have not dissipated. A Reserve Bank study published in December concluded that corporate investment might actually fall in this fiscal year compared with last. There are two conventional explanations for this. First, that 52% of GDP, and some of its most dynamic components, are in services, which are not capital-intensive. Second, according to one estimate in early 2003, 21% of manufacturing capacity lay unused after the investment splurge of the mid-1990s. Only when this slack is taken up will companies start investing again. In the meantime, banks are pouring far more money into government bonds than statutory liquidity requirements demand.

Foreigners are helping to drive up the stockmarket, but are still wary of direct investment. Their contribution looks bigger than it did, now that the Reserve Bank has restated the figures in line with international practice. But it still reported only $4.7 billion in foreign direct investment in the fiscal year ending in 2003, less than a tenth of what China attracted in 2002.

The continued caution of foreign and Indian investors alike is not surprising. The structural impediments to investment in India have been eased but not removed. They include restrictive labour laws that make it hard to shed staff. Nor, despite improvements in some areas, have the deficiencies in India's infrastructure—roads, electricity, water supply—been fixed. Laws complicating land transactions, and the labyrinthine intricacies and glacial pace of litigation, are further deterrents. So is a cumbersome and corrupt bureaucracy that adds time and cost to almost any commercial project.

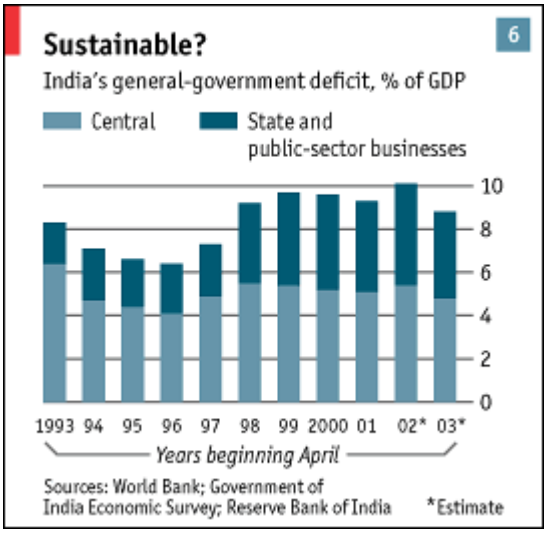
In recent years, investment has tended to make up little more than 20% of India's GDP. To achieve its 8% growth target, India badly needs to increase that proportion and to improve the efficiency with which capital is used.

Don't mention it

The government's ability to do this, however, is limited by the appalling state of its finances. Its budget deficit is now like an embarrassing foul smell. To draw attention to it seems in poor taste. Confronted with the worries voiced by the World Bank and the IMF, officials wearily point out that these organisations have been giving warning of impending crisis for years, and everything is going swimmingly.

The public-sector budget deficit has been running at around

10% of GDP for the past six years (see chart 6), a very high level by international standards. Rather more than half of the deficit is accounted for by the central government; most of the rest by profligate states. The fear is that this might lead to higher inflation, and that the government's demand for funds will push up interest rates, crowd out private investment, weaken the financial system and leave the economy vulnerable if hit by a big macroeconomic shock.



For the time being, however, there is little sign of an imminent crisis. Neither central nor state governments are likely to default, and the deficit is financed not by foreign borrowing, but by a high savings rate and a compliant banking system (in which state-owned banks account for 90% of deposits). Mr Singh, the finance minister, earlier this month forecast a marked fall in the deficit for the current fiscal year. Elections, however, usually end up widening the gap. Optimists argue that, in the longer term, faster growth will bring higher tax receipts and reduce the deficit.

But the deficit already hampers growth by limiting government spending on infrastructure, education and health. Almost all the money goes on interest payments (some 43% of recurrent expenses), civil-service wages and pensions, defence and subsidies. A fiscal-responsibility law passed last year requires the government to eliminate the revenue deficit by 2008, and gradually to reduce the central-government fiscal deficit as a percentage of GDP. It is hard to see how this is to be achieved.

Last year, an outcry prevented Mr Singh from fulfilling a budget commitment to lower the government's subsidy of the price of fertiliser. A powerful farmers' lobby in the richer agricultural states blocks reform of an arcane, costly and counterproductive system in which the government both subsidises agricultural inputs and procures wheat and rice at above-market prices, supposedly to sell cheaply to the poor (much gets diverted before it reaches them).

Mr Singh did, however, push through another unpopular measure: a reduction in the interest rates the government pays on small-savings schemes. These, supposedly designed to encourage thrift, are an expensive source of funds and keep interest rates higher than they need be. They are, however very popular with middle-class voters, and with the state governments who use them to raise money. As Surjit Bhalla of Oxus Fund Management in Delhi has tirelessly pointed out, they have become a national pyramid scheme with a pernicious effect.

Many economists argue, however, that if the deficit is to be tackled, the best hope lies on the revenue side. The ratio of total government tax revenue to GDP, at 9-10%, is actually lower than it was in the early 1990s. A decade of 6% annual GDP growth seems to have been marked by an even faster growth in tax evasion. Since Mr Singh himself has described the tax system as “suspicion-ridden, harassment-generating, coercion-inclined”, this is perhaps not surprising. It is sometimes said that the “licence raj” abolished in 1991 has been supplanted by an “exemption raj”.

A simpler, cleaner system, recommended by a government-appointed committee and endorsed by Mr Singh in his budget speech last year, might also generate more revenue. But reform of the tax regime is no easier than any other structural change. For example, harmonisation of India's cascading sales taxes by introducing a uniform national value-added tax has repeatedly been postponed. So the country has the worst of both worlds: indirect taxes push up the price of Indian goods far beyond the level of, for example, comparable Chinese products, yet the government's tax base grows no wider.

As the experience of the past ten years suggests, there is an even chance that the deficit will constrain growth even more than it does at present, rather than that growth will reduce the deficit. If private investment does pick up as hoped, then interest rates might have to rise quite quickly, choking the economy just as it is gathering momentum. Such a “death by slow strangulation”, in the words of one IMF official, is more of a risk than a sudden crisis.

What is to be done

For the IMF and others, India is a case study proving that economic reform works. Reform has brought faster growth, particularly in those parts of the country and of the economy that have opened up most to

competition, and have been least shackled by government. The most obvious example is the IT industry. Yet the arguments for reform have to be rehearsed over and over again, partly because of entrenched intellectual traditions of autarky and socialism, but mainly because reform threatens vested interests.

Mr Singh thinks that there is now a “broad consensus” in favour of reform, and that the “Indian polity has learned a great deal about the merits of liberalisation and the perils of populism.” He admits that, at election time, politicians play to the gallery, but sent an encouraging signal in January by announcing a liberalisation of foreign-ownership rules in banks and retail oil companies.

The privatisation process started in 1999 is likely to speed up this year as the government takes advantage of the stockmarket boom. But many of the “second-generation” reforms rely on state governments. These include, for example, turning electricity provision from a loss-making activity of state-owned boards into a commercial business, by unbundling generation, transmission and distribution.

State-government finances badly need rehabilitation if the rural majority is to get much-needed investment: in roads, where many villages remain cut off; in irrigation, to help free more farmers from the tyranny of the monsoon; in education, where nearly 20% of children receive no education at all and 35% of the population are illiterate; in health, where 70 out of every 1,000 children die in their first year, and at least 4.6m people are infected with HIV, which in some areas has spread from high-risk groups into the wider population.

Some grand schemes are afoot to lift the countryside. Mr Vajpayee's “Golden Quadrilateral” project of highways linking Delhi, Kolkata, Chennai and Mumbai is part of a broader road-building campaign to improve village “connectivity”. There is also a visionary (as well as hugely controversial and, at $120 billion, costly) scheme to end India's floods and droughts by linking rivers and moving water across the subcontinent. More practically, schools are required to provide mid-day meals for their pupils—a boost to nutrition, enrolment and attendance.

In many poverty-stricken areas, the most serious problem is not the lack of funds, or poor policy. It is the bureaucratic inability or unwillingness to deliver. Take India's poorest state, Bihar.

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An area of darkness

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Many Indians are being left behind

Laloo-land

AS IT gazes out over the eponymous Gandhi *maidan*, a huge public lawn in the centre of Patna, the statue of the Mahatma—as always equipped with *dhoti* (loin-cloth), spectacles and walking cane—looks steadfast but rather forlorn. On a chilly January morning, the *maidan* is covered in litter; around its edge, the homeless sleep under makeshift shelters, warmed by little bonfires of rubbish; pigs sift empty plastic bags; even the children half-heartedly playing cricket seem infected by the air of rot and neglect. Elsewhere in the city, communists are marching in protest against the government. Young thugs armed with thick sticks smash cars, bicycles and bystanders who are not quick enough to make way.

Yet under the grime, Patna, the capital of Bihar, is a pleasant enough place. As its residents remind visitors, it was also, as Pataliputra, one of India's oldest cities, and once capital of an empire that stretched from Afghanistan in the north to Mysore in southern India. It has a claim to be the ancient heart of India. These days it is seen as the armpit.

Bihar, the third most populous state in the country with 83m people, has become a byword for the worst of India: of widespread and inescapable poverty; of corrupt politicians indistinguishable from the mafia dons they patronise; of a caste-ridden social order that has retained the worst feudal cruelties; of terrorist attacks by groups of “Naxalite” Maoists; of chronic misrule that has allowed infrastructure to crumble, the education and health systems to collapse, and law and order to evaporate.

The state's image was further besmirched by the murder last November of Satyendra Dubey, an engineer working on a central-government highway project in Bihar. He is believed to have been killed for having written to the prime minister about shoddy work and corruptly awarded contracts. But this is just one in an endless stream of bad-news stories coming out of the state. Reports abound of women being harassed and assaulted on the railways. There was further violence on the trains late last year in retaliation for attacks on Bihari migrants in other states.

Despite occupying fertile land in the Gangetic plain, Bihar is the poorest state in India. According to data compiled by Mr Gokarn at Crisil, the credit-rating agency, Bihar's income per head, of about 6,000 rupees a year, is one-third the national average. A recent study edited by Bibek Debroy and Laveesh Bhandari covered the 69 most disadvantaged of India's 602 districts, the next level of administration below the state. Of these, 26 are in Bihar and a further ten in Jharkhand, which was part of Bihar until 2000. Mr Debroy says satellite photos of India at night show Bihar at the centre of an area of darkness. Electricity is a sporadic luxury.

In the rest of India, much of the blame for Bihar's poor performance is laid at the door of Laloo Prasad Yadav, who was the state's chief minister from 1990 to 1997. Jailed for his alleged involvement in a huge corruption scandal, he was freed on bail. He now rules through his wife, Rabri Devi.

Mr Yadav describes himself as the victim of a concerted campaign by the national media, dominated by the “fascist”BJP, to portray him as a joker, because he represents the forces of secularism and the downtrodden. But he relishes his image. He greeted your correspondent by showing off his toenails, damaged under a buffalo's hooves when he was a poor cattle-herding child, and conducted a tour of the grounds of the chief minister's plush residence. It is now a working farm with a variety of crops and a herd of cattle.

The new anti-elite

Mr Yadav is not alone in detecting metropolitan snobbery in much of the coverage of Bihar. Shaibal Gupta, of the Asian Development Research Institute in Patna, says the criticism is largely justified, but is given extra bite by suspicion of the new social forces in power in Bihar. He describes these as a “cockney group”, different from both the English-speaking elite who ruled India for the first two decades after independence and the “vernacular elite” who began to take over in the late 1960s, and typically spoke a standard, “Sanskritised” version of Hindi, the national language.

Mr Yadav and other “cockneys” speak their local dialect, make much of their humble origins, and owe their rise to their ability to mobilise votes along caste and communal lines. In much of India, it is often joked, people do not cast votes so much as vote castes. In Bihar, caste prejudices and feuds are as deep-rooted as anywhere in India. Mr Yadav's success stems from what he calls “MY” formula, an alliance of the Muslim minority and his own Yadav caste of agriculturalists.

This, however, has led to an ugly brand of politics, with many criminals in the legislative assembly. Some, it is widely believed, are directly involved in Bihar's biggest growth industry: kidnapping for ransom. According to a police chief, sacked last year, 80% of the force is corrupt.

Mr Yadav points out that Bihar was at the bottom of the state development rankings even before he took over. This was the fault, he says, of the centre's failure to invest in infrastructure, of its plundering of the state's natural wealth (“like picking potatoes”), and of the corruption and misrule of the upper-caste politicians who controlled the state.

Mr Gokarn agrees that it is simplistic to blame all Bihar's woes on the current regime. The state has indeed suffered economic discrimination. Until the 1991-92 reforms, a policy of “freight equalisation” (under which the cost of transporting coal and iron ore, abundant in Bihar, was based solely on weight not distance) undid its comparative advantage in steel and electricity production.

Another grievance was the low fixed level of royalties paid by the central government for the mineral wealth extracted from the region. Moreover, unlike more prosperous agricultural states such as Punjab and Haryana, the state does not benefit from government procurement of its grain surplus. And the creation of Jharkhand in 2000 left Bihar deprived of its mineral resources and of what little industry it had.

Mr Yadav and his senior civil servants reel off his government's achievements: in irrigation, power-generation, elementary education and family-planning promotion. Few of his citizens seem to notice. The delivery of almost all government services has broken down. In Dehlo, for example (see article), there is a school, but only two teachers for 250 children. The grain meant to be handed out as a substitute for a mid-day meal never appears.

One of Bihar's biggest difficulties is its surfeit of labour. In the 1990s, its population increased by 28.4%, more than that of any other big state. Hence the big annual migration of landless labourers looking for work. Mr Yadav boasts that, if Bihar withdrew its labour from Punjab, that state's agriculture would disappear. But migrant workers complain that increasing prosperity in richer states is bringing mechanisation, a labour surplus and lower wages. From two poor villages in East Champaran district, 30 men set off this January to the very southern tip of India to work on a construction project. Most had to borrow the train fare at interest rates of close to 10% a month. They know they will save little to send home. But staying behind and doing nothing is an even hungrier option.

The prospect of ever-increasing numbers of frustrated Bihari migrants roaming the country in search of

work is one of many reasons why Bihar's troubles are India's too. Another is the fear that, instead of being an outmoded remnant of a feudal era that the rest of India is leaving behind, Bihar is actually pointing the way for other states, such as the most populous of them all, Uttar Pradesh. The excesses there of Mayawati, a *dalit* (formerly, “untouchable”) leader who came to power in 2002 as chief minister in coalition with the BJP, led to her downfall in August last year. But the allegations of large-scale-corruption, and her conspicuous consumption of public resources, are not thought to have dented her popularity among *dalits*. For many of them, she was merely doing what the higher-born have always done. A *dalit* was at last getting her due.

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Bottom of the heap

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And there most landless Bihari villagers will stay

Dalit power

ACCESS to the village of Dehlo from the nearest town, Mehsi, is by a ferry-barge punted across a river, and a bumpy dirt track through a thickly populated succession of villages, in one of the poorest parts of India. A path divides Dehlo in two. On one side, in crude mud-and-thatch houses, live the local smallholders. On the other, in similar but much smaller huts, live the landless labourers.

They are Musahars, a group of *dalits*, the people once known as “untouchables” beneath the intricacies of the Hindu caste system. Even among *dalits*, Musahars suffer discrimination, and the keeping of social distance. They are disdained for their diet, of whatever will keep them alive, including snails, worms and rats. Some still work in the outlawed profession of “manual scavenging”—clearing human and animal excrement. In Dehlo, they were once bonded labourers. The local landowners would beat them if they worked any other fields, and paid them little for their labour. Some also demanded first-night bedding rights over new brides.

Now these Musahars, at least, are feeling good about themselves. A group gathered in a little clearing between their cheek-by-jowl homes explains how they organised themselves with the help of local activists supported by a British charity, ActionAid, and the British government. A series of protests in the district town secured an end to their bondage and hence a rise in pay, a legal right to live in their huts, and now the granting of a little bit of land to build new ones and grow some crops. No longer are they beaten “like donkeys”.

Their pride and sense of empowerment is inspiring, but their lot is still grim. There is only three months' work each year. They are paid in grain, and have to try to store enough to live on for the rest of the year. In bad years, some have died of hunger. Diseases such as tuberculosis, malaria and, especially, kala-azar, an often fatal fever spread by sand-fly bites, are rife. Health care is distant and mostly unaffordable. The water supply—from three hand-pumps—is polluted.

Asked what they most want from development, the men come up with the usual litany of roads, electricity and water. The women mostly want a proper school, so that their children might have a chance to escape. A far-sighted one wants a telephone in the village, so that they can keep in touch.

S. Shivkumar, the district's magistrate, or senior government official, intervened on the Musahars' behalf. But he plays down what has been achieved in Dehlo. “Real empowerment”, he says, “will only come when they have assets.” And that remains impossible, because there would be an uncontrollable backlash as soon as the “core interests” of the dominant local castes were threatened.

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Unbundling India

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What is needed is not so much trickle-down as splash-all-over

Corbis

Happy days on the roller-coaster

IF DEHLO represents one pole of modern India, another is the Dhirubhai Ambani Knowledge City, the campus of Reliance Infocomm, just outside Mumbai. For miles before it reaches the City, the approach road is lined with lamp-posts adorned with little posters in Reliance's green-and-blue livery, bearing the slogan: “A New Way of Life”. Public taxis are not allowed beyond the security gates. Thereafter transport is by zero-emission golf buggy, through grass-verged orderliness to concrete-and-glass monuments to modernity.

In one, Reliance Infocomm has a display of its wares: internet cafés, wireless mobile bank cash-machines and, a bit in the future, “home-entertainment” consoles offering television, a DVD library of Bollywood hits (with karaoke option) and broadband internet access. Dhirubhai Ambani, Reliance's founder, who died in 2002, had a vision of affordable communications for the average Indian, with a phone call cheaper than a postcard (and better for the illiterate). Ambani's elder son, Mukesh, oversaw the investment of $3 billion in an 85,000-km (53,000-mile) fibre-optic network covering most of India.

He boasts of turning India from the highest-cost voice market to the cheapest. Of India's 25m mobile-phone customers, a number growing by nearly 2m a month, Reliance already has 6m. Mr Ambani sees this as one of the first pieces of tangible evidence for the common man of the benefits of economic liberalisation. Such a man will have a mobile phone, with cheaper calls than on his old landline or local public phone. Trickle-down has worked, and this is only the beginning. By helping build a world-class digital infrastructure, Reliance, admired and a little feared for its perceived ability to sway government policy, is equipping India to compete in an age when “life will be digital”.

Mr Ambani thinks India is undergoing “a silent revolution: our young people want to fend for themselves, and the government is getting out of their way.” What troubles many is that this revolution is changing the lives of only a small urban section of the population. Even Mr Ambani is worried by the widening social disparities. India, as Nehru wrote 60 years ago, is “a bundle of contradictions held together by strong but invisible threads.” Modernisation and globalisation, far from imposing, as some have feared, a bland sameness on India, are sharpening some of those contradictions.

India has done an astonishing job of containing, in a continent-sized country, the tensions of ethnic, religious, regional, social and economic differences. But success is relative. In the ethnically diverse, non-Hindu north-east, for example, with more than 50 insurgent groups, low-level wars against guerrillas from peoples such as the Nagas and the Bodos have dragged on for decades, and in recent months have

spilled over into Bhutan and Myanmar.

Better relations with Pakistan and a lull in the Ayodhya campaign have eased communal tensions, but the casual anti-Muslim attitudes of many Hindus suggest they will resurface soon enough. As Sunil Khilnani has pointed out, the pogrom in Gujarat in 2002 was not an aberration. Rather, it made clear how "economic growth is compatible with extremism": Gujarat is a prosperous, outward-looking state with a worldwide diaspora; the rioters included well-off doctors and shopkeepers with mobile phones and government-supplied computer print-outs of Muslim addresses.

As in China, partial globalisation is increasing internal regional disparities. A handful of high-growth areas, such as those around Delhi, Mumbai and the southern corridor between Hyderabad and Chennai, are leaving the poorer areas, such as Bihar and Orissa, far behind. Yet the poorer areas' populations are growing faster. Many states are now ruled by parties that have little or no national base. Their leaders—such as Mr Yadav in Bihar, or Chandrababu Naidu in Andhra Pradesh—are elected to do their best not for India, but for their "vote banks".

Socially, Indian tradition is proving very resilient. Marriage patterns are changing only slowly from intra-caste arrangements. Some ugly traditional traits—a preference for sons, and a willingness to kill the daughters of dowry defaulters—persist even in better-off parts of India. Indeed, the practice of female foeticide, enabled by illegal sex-determining ultrasound scans, is most prevalent in comparatively rich areas, some of which, in Punjab and Haryana, now suffer an acute shortage of girls.

Television, available in about half India's homes, is spreading a shared culture. Amit Khanna, chairman of Reliance's entertainment arm, says it has also "taken the sting out of the tail of socialism" and made people feel less guilty about consuming. But even the growing middle classes, perhaps 150m strong, are torn between the national and global values they see on the screen and the strong ties of their own caste and community.

For much of the urban middle classes, however, India really is shining. Their prospects are improving fast. The challenge is both to make India as a whole richer faster, and to find better ways of distributing the benefits of more rapid growth. As India's population expands, that challenge will become ever more urgent, and ever harder.

Seize the moment

Yet the next few years should offer the Indian government its best chance yet to tackle it. Rarely has India enjoyed such favourable international prospects: of peace with Pakistan; of enhanced integration in the global economy; and of being accepted as an important world power. At home, this is helping generate a new self-confidence which, rightly managed, could produce a virtuous circle of private-sector investment, rapid economic growth and liberalising reform. That in turn might allow a reshaping of the government's budget, and of its role in the economy: as less of an employer, subsidiser and borrower, and more of a provider of the infrastructure, health care and education its people deserve. That is indeed a shining hope.

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Offer to readers

Feb 19th 2004
From The Economist print edition

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China's material needs

The hungry dragon

Feb 19th 2004 | BEIJING, LONDON, NEW YORK AND TOKYO
From The Economist print edition

Nowhere is the impact of China's growth clearer than in the world's commodity and raw materials industries. No industries will lose more if that growth slows

Get article background

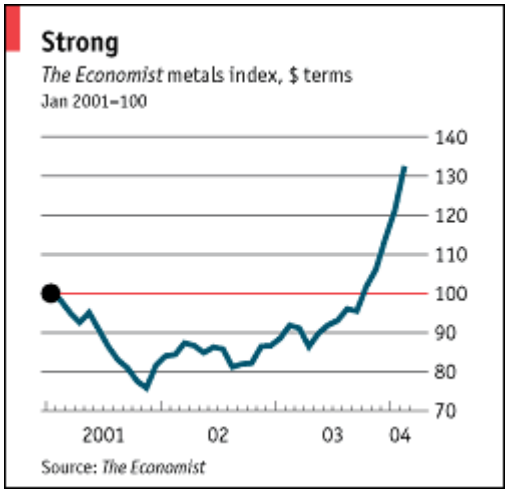
AFTER difficult times that had lasted nearly a decade, mineral and metals producers from around the world have seen their fortunes improve spectacularly during the past year. They largely have China's booming economy to thank for this. In 2003, China's GDP grew by a reported 9.1%, its fastest rate since 1997—driven by the material-intensive construction and automotive sectors. Ravenous China's oil imports rose by 30% last year, exceeding Japan's to become second only to America's. China accounted for half of the world's consumption of cement, 30% of its coal, and 36% of its steel (of which imports jumped by 50%), according to China's National Bureau for Statistics. Copper imports rose by 15%, and nickel imports more than doubled. This helped to lift *The Economist* metals-price index by around half from a year ago, and by 75% from its low after September 11th 2001.

This, in turn, has done wonders for the share prices of firms such as Rio Tinto, BHP Billiton, WMC Resources, and Alcoa—each of which are up on a year ago, by 20%-90%. Goldman Sachs recently raised its profit forecast for these and similar firms, predicting that “China will remain a powerful driver of global demand growth for many commodities in 2004 and beyond”.

True, not everyone is happy. Rising global commodity and material prices hurt consumers everywhere, not least in America—though the fall of the dollar, in which many commodities are priced, should ease the pain of the price rises in much of the world, especially in Europe.

Higher input prices are hurting some of the marginal steel producers and copper smelters. Japan's Sumitomo Metal Industries and Nisshin Steel are switching to lower quality inputs to hold down costs: in fiscal 2004, Nisshin expects to raise its use of low-iron material by half to 30% of its total iron-ore consumption, compared with fiscal 2000. Recently, due to higher ore prices, several Japanese copper smelters said that they will cut

production.



For the most part, though, the commodity and materials firms are being energised by the growth opportunity presented by China. David Humphreys, chief economist of London-based Rio Tinto, says that China will become increasingly central to his firm's planning, despite accounting for less than 10% of its current business. That figure understates China's significance, because “the truly important thing is the growth segment, and that is where China is so dominant. What is now taking place there is on a scale that has no real precedent.” For some commodities, such as iron ore, China in effect accounts for all the world-wide growth, he adds.

Rio Tinto plans to form a joint venture with Mitsui, Nippon Steel and Sumitomo Metal Industries in western Australia to improve the efficiency of production and increase the speed with which output is shipped. Mitsui, which has an established partnership with China's mighty Shanghai Baosteel, plans to build ten more steel-processing plants in the country, raising capacity from 1.3m tonnes per year to 3m. Although BP last week said it has sold its 2.1% equity stake in China Petroleum and Chemical (Sinopec), the British oil giant still plans to invest a further $3 billion in China over the next five years, on top of the extensive activities it already has there.

China itself is doing its utmost to benefit from the strong demand it has created—and, it hopes, to reduce its exposure to supply bottlenecks, which have been a chronic headache. (In November, six Chinese copper smelters announced plans to cut back production because of inadequate supplies of copper concentrate.) One strategy is to acquire equity stakes in resource-based businesses around the world. This may be a good selling opportunity for overseas shareholders. Ren Haiping, of the Institute of World Economics and Politics at the Chinese Academy of Social Sciences in Beijing, acknowledges that Chinese firms, with their state-owned, central-planning pedigrees, have much yet to learn about wheeling and dealing in the wider world. “They will, of course, make mistakes and bad deals, and there are lessons that will have to be learnt. But the government is prepared to tolerate this because it understands that this is the path China needs to take,” he says.

Spend, spend, spend

Notable examples of recently acquired Chinese stakes, which may or may not pay-off, include a planned joint-venture between Baosteel and Companhia Vale do Rio Doce, a Brazilian iron ore producer, whose sales to China grew by 33% a year in 1998-2002, to build one or two steel mills in Brazil, capable of producing 4m tonnes of steel a year. Worth perhaps $2 billion, it will be one of China's largest overseas investments so far. In January, Sinopec won a contract to develop natural gas in Saudi Arabia. China has also invested hundreds of millions of dollars in oil projects in Gabon and Algeria. And it is participating in aluminium, copper, nickel, and iron-ore projects in Jamaica, Zambia, Peru, Australia and Papua New Guinea.

The Aluminum Corporation of China recently announced plans to invest over $1 billion in a new aluminium project in Vietnam. It will not only provide most of the capital and technology, but also arrange the necessary railway construction. It plans at least ten other projects abroad to meet domestic demand for aluminium, which it expects to triple by 2020.

Though the future looks bright, there may be a few clouds on the horizon. The uncertain scale and effectiveness of Chinese activity in the raw materials markets ought to temper the optimism of foreign firms. So too should the risk that China's economy will go off the rails—though there have been encouraging signs of late that the government is applying some gentle pressure on the economic brakes to avoid unpleasantness later. It is also possible that today's high prices are giving misleadingly upbeat signals. Rick Holmes, a metals trader at Mitsui Australia, though generally bullish, says that a significant, but unknowable, portion of Chinese commodity buying is for arbitrage and speculation rather than physical demand.

Even so, dealing with China is far simpler for foreign commodity businesses than it is for other foreign direct investors, manufacturers or retailers. In China, as elsewhere, they need not worry about finicky or unfamiliar consumer tastes, trademark piracy or cut-rate copycat producers. As long as China needs

more materials than it has, their businesses will thrive.

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Chinese shipping

Full steam ahead?

Feb 19th 2004
From The Economist print edition

Chinese shipping, and shipbuilding, are sailing swiftly

IN the 15th century, China was a big maritime power. It roamed the Pacific with ships six times larger than those of Christopher Columbus. Is China at long last about to regain sea-going pre-eminence? It aims to become the world's leading shipbuilder by 2015, displacing South Korea and Japan. It is already a leading builder of the kind of simple dry-cargo ships which carry iron ore, copper and other raw materials to its own booming factories. And it is starting to build more complex vessels, such as tankers and container ships.

Waigaoqiao, a shipbuilder in Shanghai, has orders for more than 25 heavy bulk carriers, each of 175,000 dead-weight tonnes (ie, the loaded weight of the ship), the most yet for a Chinese-built ship. The first of the ships was delivered on February 9th; later this month Waigaoqiao will begin work on an oil tanker. By the end of the year, Shanghai shipyards expect to have increased production by two-thirds over 2003.

This is only the beginning. In December, China State Shipbuilding Corporation (CSSC) began to construct a shipyard on an island just off Shanghai. When completed in 2015, it will be able to produce 8m dead-weight tonnes of ship per year, making it the largest such yard in the world.

In 2003, Chinese shipyards accounted for one-tenth of world output, but the country's goal is much higher. Meanwhile, booming trade in and out of China is creating a huge global demand for ships. In 2003, Shanghai and Shenzhen (near Hong Kong) became the world's third and fourth busiest ports, trailing only Singapore and Hong Kong itself. There has been a 350% rise in bulk shipping rates in the past two years. According to Howe Robinson, a London shipbroker, the fourth quarter of 2003 saw an unprecedented spike in charter rates for bulk shipping, mostly due to a 17% rise in Chinese industrial production. Similarly dramatic increases are under way in oil-tanker rates and in prices for shipping containers full of Chinese manufactured exports.

But China's shipbuilding business may have to weather some storms in pursuit of its long-term goal of world domination. A recent report by investment bankers Goldman Sachs suggests that container-shipping rates will peak this year, with steep falls likely in Asia-America and Asia-Europe rates in 2005 and 2006. And, beyond that, orders already placed for new, large vessels of the type used to cross the Pacific are equivalent to almost 40% of existing capacity. There could soon be a glut of container ships to serve China and America's west coast. So much for plain sailing.

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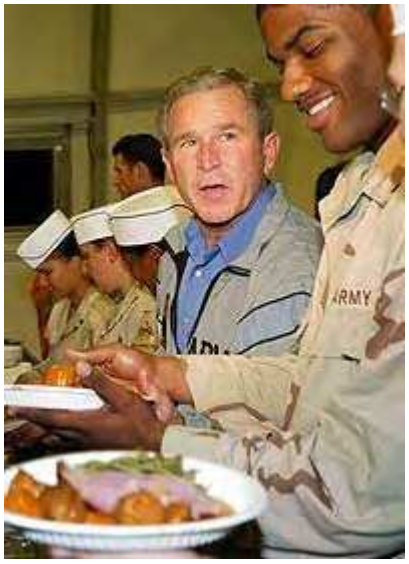
Halliburton

What we know

Feb 19th 2004 | NEW YORK
From The Economist print edition

A scandal-hit firm fights back

AP



Cheney's paying for this

“LARGE contracts have been awarded by the Pentagon without the benefit of a competitive, transparent process.” The result, insisted Byron Dorgan, a Democratic senator, is a torrent of “waste and abuse” by the firm that benefited from those contracts. Former employees of this much-maligned firm have provided him with salacious examples of corporate excess. One Democratic presidential candidate after another has taken turns denouncing this same company for all manner of ills, ranging from price gouging to influence peddling, in its work in Iraq.

The firm in question, of course, is Halliburton. If its critics were only politicians from the Democratic Party, such allegations could be dismissed as just so much election-year mud being slung at Dick Cheney—the firm's boss before becoming George Bush's vice-president. If only.

The list of allegations, and not just relating to Iraq, is growing fast. There was a bribery scandal in Kuwait, and a flap over the price of petrol imported into Iraq from Kuwait. Then it surfaced that the firm may have charged American taxpayers for millions of meals that were never actually served to soldiers in the Middle East. Though denying wrongdoing, Halliburton has just decided to delay billing for $140m. American and French officials are now investigating whether a consortium including Halliburton made questionable payments of $180m in Nigeria, relating to a natural-gas project. America's Treasury Department is now sniffing around the firm's involvement in Iran to see if it has violated the sanctions imposed by America.

After fumbling for ages, Halliburton is now fighting back. David Lesar, its chief executive, has become much more visible. He has penned opinion pieces pushing his firm's rebuttals, and launched an upbeat, patriotic advertising campaign to counter the negative media coverage (the product, he says, of “the sieve of personal bias”). The nub of this campaign is its insistence that the firm won its contracts because of “What we know, not who we know.”

Will it work? Halliburton believes that most Americans do not, in fact, think badly of the firm. That may seem unlikely, given the unrelenting media barrage of recent months. Yet, it seems, an extensive survey done for the firm found that the vast majority of Americans had no opinion about Halliburton or had never even heard of it. This may, then, be fertile ground for “reputation enhancement”.

Maybe. But, assuming Mr Cheney remains on the Republican ticket (see article), Halliburton's advertising spend will have to contend with still greater Democratic efforts to convince the public of the opposite. After all, have not the firm's revenues from the Pentagon shot up during Mr Cheney's tenure as vice-president, from $500m in 2002 to some $3.9 billion last year? The Democrats plan to hold noisy Congressional hearings on the firm in March. But does Halliburton really need to be popular, with the public at large or with opinion formers? Mr Lesar insists that, even if Mr Cheney had never gone to the White House, his firm would have won the same number of contracts, because “we are the biggest and the best.” In which case, the current hullabaloo should not matter. Halliburton's business ought not to suffer if it really does win contracts because of what, not who, it knows.

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Microsoft

Code, but no ethics

Feb 19th 2004 | SAN FRANCISCO
From The Economist print edition

Microsoft stumbles from one security fiasco to the next

Get article background

HARDLY a week now goes by without another security crisis for Windows, Microsoft's ubiquitous operating system. On February 10th, with the MyDoom virus—the fastest-spreading ever—finally in remission, Microsoft announced the discovery of another embarrassing software flaw. As usual, it also released a software patch for users to download to protect their machines. But, as ever, the race was on for hackers to spread their viruses before those patches are installed.

Sure enough, soon the programming code for one such virus was found on a French website. Writing malicious software, in most countries, counts as “freedom of expression”. Hackers, motivated mostly by kudos within their subculture, typically only publish viruses, leaving others to commit the crime of distributing them. This may now be happening. On February 17th, a new variant of a virus called Bagle started to spread. Others may not be far behind. A repeat of last summer's Blaster worm, or worse, may be only a matter of time.

Adding insult to injury, on February 12th another geek with a dislike for Microsoft (one of many) leaked on to the internet millions of lines of the source code that underlies two versions of Windows. Microsoft quickly pointed out that the leaked bits were just a small part of the operating system, but it simultaneously noted that it takes such violations very seriously and is working with the FBI to find the culprits.

Even tracking them down, however, would not be much of a victory. The real embarrassment is that each new incident invites more unfavourable comparisons between Microsoft and its chief rival, Linux. As an operating system, Linux has had to endure far fewer viruses. Microsoft argues that this is only because Linux (which mostly runs on big server computers, rather than desktops) is a smaller target and thus gets attacked less.

The Linux camp counters that their operating system itself is safer, thanks to the way in which it is written—as a collaborative project by thousands of volunteers all over the world who, like hackers, are motivated by peer recognition, not pay. Microsoft tries to keep its code secret. Linux makes its code freely available to all who want to see it, use it, or contribute to it. It is impossible to leak Linux on the internet, for that is where it has been all along.

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Japanese carmakers

The also-rans

Feb 19th 2004 | TOKYO
From The Economist print edition

Mitsubishi and Mazda struggle, despite western partners

FORGET the headlines about Nissan's amazing recovery, about Toyota overtaking Ford as the world's number two carmaker and about Honda's incredible flexible manufacturing system conquering the world. Below the top tier of Japanese carmakers are other famous names that are struggling. Mitsubishi has DaimlerChrysler as a 37% shareholder, while Mazda is 33% owned by Ford Motor; yet each is finding the going tough both in their home market and in America, where their bigger brethren have been doing so well.

On February 19th, Mitsubishi released yet another quarter of dismal earnings, amid rumours that there would soon be big management changes intended to get the firm back in gear. Mazda raised profits a bit in 2003, but analysts say that it will be mid-2005 before new products really have a chance to improve its fortunes.

Their problems highlight three key features of the global car industry. First, the role that competition at home plays in shaping the performance of Japan's world-beaters. The domestic car market is mature and, unlike other Japanese sectors, fiercely competitive. Sales fell from 7.8m to 5.9m cars in 1990-98, and have remained flat since. Yet eight domestic firms still scrap for customers.

And the pounding will get worse, says Kunihiko Shiohara, a car analyst at Goldman Sachs. Toyota is to streamline its sales network this year and launch its premium Lexus brand in the home market next year, intensifying competition. Honda and Nissan may find ways to hit back. The goal for Mazda and Mitsubishi, by contrast, is simply to earn enough money overseas to offset their unprofitable home market.

That leads to the second lesson: no matter what a car firm's other global strengths, it is hard to make good money these days without succeeding in America. Mazda's sporty cars and rotary engines, for example, do very well in Europe. Mitsubishi earns good profits in the rest of Asia, a market that surpassed Japan last year. Yet both firms have struggled in America. So their overall profit margins were roughly 2% each in the year to last March, compared with 8% or more at Toyota, Honda and Nissan, each of which thrives in America.

Why have Mazda and Mitsubishi failed there? That points to the third big industry-wide trend: global integration. This is about more than outsourcing manufacturing to places with cheap labour, or producing cars near to where they are sold. To compete both on cost and marketing, big car firms have had to squeeze a variety of new models onto ever fewer basic chassis and engine designs. Co-ordinating design, manufacturing and marketing profitably is a huge challenge. Witness the failure of DaimlerChrysler and Ford to help their Japanese affiliates in the American market.

As he sums up Mazda's problems, the words of Noriaki Hirakata—an analyst at Morgan Stanley—would be music to the ears of any Japanese engineer: “Mazda has fantastic product development and first-class manufacturing, but it is stuck with Detroit marketing.” Goldman's Mr Shiohara agrees that Ford has gained from Mazda's technology, but failed to help it find a profitable American niche.

Mitsubishi's problems in America may be more of its own making. After it launched a line of mini-cars aimed at young, low-income buyers, it lured them with “zero, zero, zero” financing: no money down, no interest payments, and no repayment of principal for the first year. This was one zero too many. Mitsubishi racked up huge losses as its young, impecunious buyers failed—surprise, surprise—to start to make payments when their year was up. DaimlerChrysler bears some blame for letting this happen in a market that Chrysler managers should have understood. Meanwhile, Mitsubishi's one area of success has been Asia outside Japan. There, it has been helped not by DaimlerChrysler but by the marketing prowess

of its *keiretsu* partner, the Mitsubishi trading company. So, who needs westerners?

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Road tolls in Germany

Trucking hell

Feb 19th 2004 | FRANKFURT
From The Economist print edition

Another humiliating blow for German industrial policy

MANFRED STOLPE, Germany's transport minister, is getting plenty of free advice these days on how to correct one of his government's costliest mistakes. A road-toll system for heavy trucks, due to start in January 2003, is still not in place. The earliest it could be, even partially, is January next year. Meanwhile the cash-strapped government is unable to collect €156m ($200m) a month in tolls.

This week a frustrated Mr Stolpe cancelled the contract with Toll Collect, a consortium of three prestigious companies, DaimlerChrysler, Deutsche Telekom and Cofiroute, the French motorway operator. He is obliged to give them two months to come up with a new plan, including better guarantees to fill the revenue shortfall, which he estimated could total €6.5 billion by the time the project is implemented—assuming no further slippage. But hopes that the consortium can improve its offer are low. An old truck-licensing system, discontinued in August, may be re-introduced to bring in around €40m a month in revenue. Since August, heavy trucks have been driving through Germany for nothing.

The German press and politicians of all stripes have been shelling out ridicule and blame, some even calling for the consortium to be prosecuted for fraud. But many different factors contributed to this cock-up, extra-embarrassing for a country that prides itself on its mastery of planning and technology. Mr Stolpe is (for now) keeping his job.

Meanwhile, developers of rival fully-functioning road-toll systems in Austria and Switzerland are beating a path to his door. Each says that it can provide a cheaper, simpler solution—at least until Toll Collect's over-ambitious technology gets through its teething troubles.

The Toll Collect project is the only one that relies primarily on America's satellite-based global positioning system (GPS) to track vehicles and gather data from them. The Swiss system, developed by Fela, and the Austrian system, developed by Italy's Autostrade, are microwave-based, and relatively cheap. Austria's Go-Box, attached to a lorry's windscreen, costs just €5.

The box for Toll Collect's system has already cost truckers around €300 each—which has done nothing for its popularity. That is because, as well as collecting tolls, it is supposed to gather traffic flow and vehicle-specific data, offering an opportunity to pioneer “smart vehicle” technology, and help national champions such as DaimlerChrysler and Deutsche Telekom to establish a leading position in it. Still, says Antonio Marano of Autostrade, “Why choose a $10,000 watch when a Swatch will tell the time just as well?”

Toll Collect relies on the interplay of GPS positioning, infrared, mobile phone and internet technology, as well as sophisticated data collection. The data include readings from an on-board gyroscope—to establish if the truck is moving in a straight line, turning or stationary—and a tachometer, to cross-check the distance covered. Because GPS is accurate to around 10m (33 feet), but can sometimes err by up to 80m, infrared crossbeams must be placed at crucial points to clarify ambiguous readings and detect errors. Marrying all this into a workable system is taking far longer than anticipated. Some critics say it will never happen. Others say that only Galileo, Europe's planned satellite navigation system, will give the accuracy required. But Galileo is at least four years—more realistically, eight years—from completion. Contractors have only just been short-listed. Not even Mr Stolpe can wait that long.

Autostrade and Fela each say that they could have a system working in Germany in 18 months. Mr Stolpe, whose ministry met each of them last month, has left open the possibility of Toll Collect taking on new partners. But a Toll Collect spokesman rules out the idea. It hopes to start collecting tolls at the end of this year—six months ahead of any alternative proposal. But Toll Collect's shareholders have been

unwilling to back that boast with a financial guarantee. (Indeed, DaimlerChrysler is said to want to quit Toll Collect.) Perhaps they are still haunted by the nightmare, recounted in the weekly *Der Spiegel*, of the horse that strayed onto a motorway during a test run last year and was duly registered: “only two axles: no charge”.

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Face value

After Parmalat

Feb 19th 2004
From The Economist print edition

Matteo Arpe and the noble pursuit of better banking in Italy

ONCE upon a time in Italy top bankers learned to play a delicate game. As they did their normal bankerly things, they knew that at any moment they might receive a phone call requesting help: could they use their influence with a longstanding client in trouble, or perhaps a smaller bank that needed a friendly rescue? Even the cleverest of the bankers sometimes struggled with the complex politics of the business. When did a favour turn from the sensible into the corrupt? Many a banker was compromised once he had agreed to do something “convenient”. This rottenness lay at the core of Italian banking.

Today a new mood is evident. Consider, for instance, a stricture laid down by Matteo Arpe, boss since July 2003 of Capitalia, Italy's fourth-largest banking group, embracing three banks: Banca di Roma, Banco di Sicilia and Bipop Carire. Italian banking must change, he says. There are things that are legal and others that are illegal, things that sound good and those that sound bad. Illegal deals by definition are unacceptable. But Mr Arpe wants to go further: deals must be both legal and sweet-sounding.

Hang on a minute. Is not Capitalia hugely exposed to Parmalat, the bankrupt and scandal-ridden food group that may have defrauded investors of more than €10 billion ($13 billion)? And was it not the house bank for Cirio, another food group that controversially went bust in late 2002 and whose former chairman, Sergio Cragnotti, was accused of fraud and arrested on February 11th? Capitalia does not seem the most obvious place to foster the modernisation of Italian banking. Indeed, if anything, it seems to exemplify the flaws of the old system.

Look again, however, and Mr Arpe appears less out of touch with reality. True, Capitalia's peak exposure to Parmalat was some €394m (today it is €40m less). But a good chunk of its lending was covered by collateral and stands a reasonable chance of being recovered. Moreover, Capitalia lent to Parmalat's operating companies, not to the financial arm where the fraud was orchestrated. Capitalia had no derivatives exposure. Nor, after Mr Arpe's arrival, did it underwrite any of Parmalat's bond issues.

The Cirio case is more awkward, if equally revealing. Mr Cragnotti had longstanding relations with Cesare Geronzi, Capitalia's chairman, who hand-picked Mr Arpe to run his banks. Mr Geronzi is one of the great survivors of Italian banking, but arguably he let Mr Cragnotti go too far. By the time Cirio went bust, Mr Cragnotti personally owed the bank around €500m, and his company owed much more. Mr Arpe courageously called time on the lending to his (disbelieving) client. When loans are non-performing, he says, clients become counterparties. That was a shock to Mr Cragnotti, who to this day vituperatively

blames Capitalia for the failure of his group.

Mr Arpe is as modern as the banking code he endorses. Since he arrived, aged 37, as general manager of Banca di Roma in May 2002 he has made a huge impact. He cut his banking teeth during 12 years at Mediobanca, a Milanese investment bank that dominated post-1945 Italian finance. He was a protégé of Enrico Cuccia, for decades Mediobanca's famously powerful boss. Mr Arpe made his name working on big privatisations, such as that of Telecom Italia. Along the way his talent inspired jealousy, and he abruptly quit Mediobanca in 1999, resurfacing at Banca di Roma after a spell in London with Lehman Brothers.

It was not an obvious role for him. He had no commercial banking experience. He was very young—at least by Italian standards—to be put in charge. Moreover, Banca di Roma, in particular, was in dire trouble after years of slack lending. But Mr Arpe relished the chance to show that he could manage people and turn the group around. Mr Geronzi promised that he would not meet interference, even if proposed reforms were tough.

Looking good

The numbers—Parmalat apart—since his arrival are certainly impressive. Operating costs have been slashed. Capitalia has lifted its core capital ratio from a weak 5.3% to a respectable 6.9%, partly by shedding €30 billion of financial risks, such as derivatives and off-balance-sheet exposures, and partly by rigorously tackling a huge €13 billion portfolio of non-performing loans. Archon, a joint-venture with Goldman Sachs, is managing more than €6 billion of bad loans with incentives to recover money quickly. Provisions of €3.2 billion, equivalent to two-thirds of Capitalia's market value, have been squirreled away. All this, as Mr Arpe says, without recourse to shareholders.

Mr Arpe has also reshaped Capitalia's governance, not least by focusing on curbing bad lending. He now spends one-third of his time chairing a central credit committee, and has veto power over every loan. Managers of Capitalia's loan portfolio are wholly independent of the bankers who make the loans.

Finally, Mr Arpe has overseen a cultural shake-up. More than 200 new managers have joined the group. Almost everyone else has been moved to a new position. One new hire is an ex-banking analyst who a few years ago had refused to cover Banca di Roma on the grounds that its reported numbers were too unreliable. Now, he says, perhaps not wholly surprisingly, Capitalia is the bank of choice for ambitious young graduates.

Much remains to be done. Though out of intensive care, Capitalia remains in the recovery ward. Though pleased by its progress, investors remain somewhat sceptical. There continues to be talk of Capitalia having to merge, sooner or later, with another big Italian bank—though none seems noticeably keen to take on its bad debts. Mr Arpe will need luck as well as skill to complete his job. But he has a certain flair. Amid the bad publicity due to Cirio and Parmalat, he decided to reimburse retail customers for worthless bonds in those firms that they had been sold by Capitalia's salesforce. The cost will be €41m. The goodwill it generates should be worth far more than that.

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Mergers and acquisitions

When battles commence

Feb 19th 2004 | LONDON, NEW YORK AND TOKYO
From The Economist print edition

NHPA

Hostile bids are back again. Who should rejoice?

Get article background

THIS week, in both America and Europe, corporate bosses locked horns as the biggest hostile bids in years twisted and turned their way towards a denouement. Even in gentlemanly corporate Japan, where hostile bids are a rarity, at least two big companies are fighting off the unwanted attentions of outsiders. The boom in mergers and acquisitions in the late 1990s was notable for agreed deals between CEOs who made them as sweet as possible for themselves. Is the boom that many forecast for this year going to be equally notable for long contested corporate tussles? And, if so, who is going to benefit the most this time?

So accustomed are investors to the idea that companies overpay for acquisitions that news of a takeover bid almost invariably sends the target company's share price soaring. Comcast's hostile bid for The Walt Disney Company on February 11th pushed up the moviemaker's share price to $28, well above Comcast's initial offer. Comcast has been busily trying to persuade investors that it is not interested in paying current market prices for Disney. Yet who can blame them for hoping? On February 17th, Cingular, an American wireless telecoms company, agreed to buy AT&T Wireless, a weaker rival, for $41 billion in cash, about twice the price that the market was putting on the intermittently profitable firm just over a month ago.

To be fair, the price for AT&T Wireless had been pushed up during a bidding war last weekend with Vodafone, a rival telecoms carrier. Shares in Vodafone, whose British management was supposed to have sworn off big, visionary mergers, soared sympathetically following the news that it had lost the battle.

With their usual fancy, investors have imagined that everyone from John Malone, the boss of Liberty Media, to Barry Diller, a media mogul who runs a collection of internet businesses, wants to get their hands on Disney. But as *The Economist* went to press, no second bidder had yet emerged.

On March 3rd, Disney's boss, Michael Eisner, will face his shareholders at the firm's annual meeting in, of all places, Comcast's home town of Philadelphia. A chunk of them may be supporting the efforts of two former Disney directors, Roy Disney (nephew of founder Walt) and lawyer Stanley Gold, to give Mr Eisner the boot. Even more shareholders will want to know why negotiations to renew a deal with Pixar, an animation company whose partnership with Disney has produced hits like “Finding Nemo” and “Toy Story”, fell apart last month. Over everything hangs the suggestion that, having rescued Disney in the 1980s, Mr Eisner's management has more recently been depressing the share price.

Disney's board politely rejected Comcast's offer this week, pointing out that the cable company's shares (which it wants to use as currency) have fallen since it made its offer—and that Disney's have risen. So the suitor is offering significantly less than the company is fetching on the New York Stock Exchange. As the mathematics of the offer ebb and flow, the market's attention will turn to Disney's defences and how well it can exploit them.

Poisonous tactics

How successful the next wave of hostile bids is will depend largely on a shifting legal and regulatory framework which, despite some surviving obstacles, seems to be making them easier than in the 1990s. In America, corporate law is the province of state governments. There was a time when, as in Europe, American firms could hope to rely on friendly local governments to help them out of a tight spot. As hostile bids flourished during the 1980s, states such as New Jersey, Ohio and Pennsylvania rushed to pass management-friendly anti-takeover laws.

This still happens occasionally. Last year, Simon Property and Westfield America, two shopping-mall operators, dropped their $1.7 billion hostile bid for Taubman Centers, a rival, after the state of Michigan passed a law that effectively killed their bid. But such laws have become highly controversial, and they may now be beyond the hopes of all but the most generous patrons.

About 40% of the 5,500-odd publicly owned companies tracked by Institutional Shareholder Services, a research organisation, employ a poison pill. Typically, this is a device that allows shareholders in firms threatened by a hostile bid to buy new shares in their company at a big discount. That makes it more costly to take over the firm by tendering for its newly enlarged pool of equity.

At the same time, 60% of American firms have a staggered board, under which different groups of directors are elected in different years. This device hinders attempts to take over companies because it can take years for shareholders to materially change the composition of the board. In a recent paper, Lucian Bebchuk of Harvard Law School argues that staggered boards cost shareholders about 4-6% of their firms' market value by allowing entrenched managers and directors to spurn attractive offers.

Oracle has had to tackle both a poison pill and a staggered board in its current attempt to take over PeopleSoft, a rival software firm. The legality of PeopleSoft's poison pill awaits a ruling from the courts in Delaware where the company (like the majority of publicly owned American firms) is incorporated. Although that ruling may now never come—this month, justice-department lawyers said they would recommend that the deal be blocked on antitrust grounds—there remain interesting questions about the way in which the rulings of Delaware's courts are evolving.

What will Delaware wear?

The state's most famous ruling came in 1989. That year, its supreme court judged that Time's directors could “just say no” to a $200-per-share hostile bid from Paramount, forcing shareholders to accept a $138-per-share friendly bid from Warner instead. More recently, however, Delaware has found itself undermined by several federal incursions into its authority. As part of its efforts to ward off further federal attacks, Delaware may feel the need to revisit the thinking behind the Time Warner ruling. If PeopleSoft does not present it with an opportunity, perhaps Disney will.

Oddly, for a company frequently accused of entrenched management, Disney has neither a poison pill nor a staggered board. The firm dismantled both defences after a row with activist shareholders in 1999. It has turned for help in its defence to Marty Lipton, a founding partner at the law firm Wachtell, Lipton, Rosen & Katz and a leading source of advice on how management should defend itself from hostile attacks.

The Disney board may eventually have to confront two tough questions. One is whether it can still (as Time did) just say no at any price. The other is whether it can approve and justify extra-legal defensive measures. These could include Disney itself buying a firm or returning billions of dollars to its shareholders via, say, a big share buy-back. Both moves could well kill off Comcast's interest in the company.

Europe is also currently hosting a giant hostile takeover bid, one that in value at least is on a par with

Disney's. The €46 billion ($58 billion) bid by Paris-based Sanofi-Synthélabo for its bigger pharmaceutical rival, Aventis, was rejected this week by Aventis's board because the cash-and-shares offer “is clearly inadequate from a financial standpoint”. Aventis also claims that there are problems with its rival's products—in particular with Sanofi's popular anti-thrombosis drug Plavix, which is facing a challenge to its patent in America.

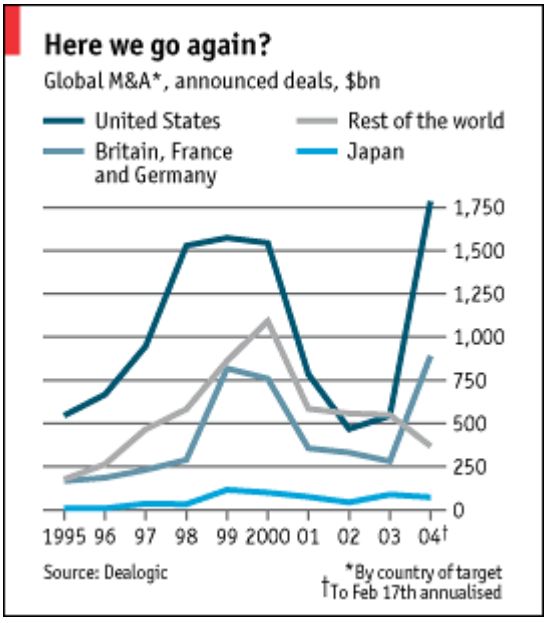
Defences in Europe against hostile bids are notoriously more robust than those in America. But the battle between the two pharmaceuticals giants shows that, despite the efforts of some countries to maintain elaborate takeover defences, the walls may be slowly beginning to crumble.

Aventis, a Franco-German group, has bought itself some time by launching an appeal against a decision by France's financial-markets authority that there are no grounds to block the bid. It might also search for a white knight to counter the bid: the Swiss group Novartis and America's Johnson & Johnson are two potential suitors that have been mentioned, although both have refused to comment.

Analysts, however, do not think such defensive tactics will get very far. Much will depend on the Kuwait Petroleum Corporation, Aventis's biggest shareholder with 13.5%. If it likes the look of the deal, it could convince other investors to go along with it. Having shareholders decide the fate of a takeover, instead of a cosy club of bankers, businessmen and politicians, will be a bit of novelty for France.

To help persuade shareholders of the merits of his offer, Jean-François Dehecq, Sanofi's chairman, announced on February 16th an 18% rise in net profits for 2003. He also said that research on some of the company's important new drugs was encouraging. These include Rimonabant, a treatment for both obesity and quitting smoking. It could, he says, have enormous potential, especially in America—which is where Sanofi hopes to take advantage of Aventis's bigger salesforce.

Putting such deals together in the European Union (EU) is supposed to get easier from May 1st when a new merger regulation comes into force. The European Commission wants to encourage cross-border takeovers and a much-needed consolidation of some of the area's fragmented industries. It recently agreed to a merger of the Dutch airline KLM and Air France. Although both carriers had to give up some take-off and landing slots at congested airports in Amsterdam and Paris, the combined group will become Europe's biggest airline. And it is possible that Italy's Alitalia may also join the group.



To encourage more such deals, the commission wanted the new regulation to lower defences against hostile takeovers. But some countries resisted, in particular Germany and Sweden, which are still anxious to protect big national companies from foreign predators. Hence the regulation which the EU's lawmakers approved last autumn was much weaker than the version which the bureaucrats at the commission had wanted.

For example, instead of an EU-wide ban on multiple voting rights and unapproved poison pills, it will now be optional for member states to ban them. Moreover, companies will be allowed to deploy such tactics if they face a hostile takeover by a company based in another country, such as the United States, that allows such defences.

No yen for a fight

Japan has few defences against hostile takeovers, largely because it doesn't need them. Hostile takeovers there are a rarity. But maybe not for long. Companies that have break-up values in excess of their market capitalisation (and there are many in Japan) are increasingly becoming the targets of hostile bids. Last December, Steel Partners, an American-based investment fund, launched a hostile bid for Sotoh, a textile-dyer. In its defence, Sotoh turned to NIF Ventures, an arm of Daiwa Securities, the country's second-largest stockbroker. NIF charged in as a white knight and backed a rival management buy-out. After a rare one-and-a-half-month-long bidding war, on February 16th Sotoh withdrew its support for the deal. Instead, it announced that it would raise its dividend 15-fold for the current year, a strategy that appears to have been successful. The next day its share price surged to almost 20% more than Steel Partners' offer.

Sotoh's move follows a similar decision last month by Yushiro Chemical to raise its dividend ten-fold in order to thwart a hostile bid that it had received from Steel Partners. And this seems likely to become the defence strategy of choice for cash-rich companies. High dividends are especially attractive in Japan because interest rates there are near zero. With their new dividend policies, Sotoh and Yushiro are now offering their shareholders yields of more than 10%.

Japanese shareholders are becoming more demanding partly because of the unwinding of cross-shareholdings between Japan's banks and their corporate chums. This has put many of the freed-up shares in the hands of foreigners or local activists. Yet despite these glimmers, the pace of change is still glacial. Traditional stakeholders, such as labour unions and banks, remain very powerful and often override the interests of independent shareholders.

On February 16th, Kanebo, a company with an excess of liabilities over assets of ¥63 billion ($600m), decided to abandon the sale of its core cosmetics division to Kao, the largest toiletries company. The event shows how far Japan has yet to go. The deal, which had been all but signed, would have created the second-largest cosmetics company in the biggest domestic industrial takeover to date. But Kanebo's powerful labour union strongly opposed the sale, as did SMFG, a big bank and its largest creditor.

Instead, Kanebo has sought comfort in the arms of the Industrial Revitalisation Corporation (IRC), a government-run corporate-rescue vehicle. One suggestion is that the IRC will buy most of Kanebo's interest-bearing debts, paying as much as 25% more than Kao's offer. The IRC will then take a majority stake in the group's cosmetics division when it is spun off in May. The message sent out to the market is that future deals involving troubled companies could well face last-minute reversals if managers feel that the government will offer less demanding terms.

Who thrives in the end?

One big unanswered question is whether the latest mergers will perform any better than those during other waves of mergers. In a forthcoming study* three American-based economists paint a picture of financial carnage in the period 1998-2001. After examining the acquisitions of some 4,136 American companies during that time, they found that the announcements of the bids reduced the combined stockmarket value of the merging firms by a whopping $158 billion.

Shareholders of the buying firms saw their wealth reduced by an aggregate $240 billion—some 12% of the purchase price. This compares with losses in the next worst four-year period since 1980 (1980-83) of $5.1 billion, less than 2% of the purchase price. Hitherto, most studies by economists had found mergers to be modestly value-creating on average.

A series of studies of American firms stretching back to the 1950s had found that merger announcements led to an increase in the combined value of the acquirer and its target of around 5%, with most of the increase going to the selling shareholders. The studies disagreed, however, about whether shareholders of buying firms typically made tiny gains, or tiny losses. Studies of European firms before 1998 told a similar story: one of modest value creation, with most of the benefit going to the sellers.

So why was the performance in 1998-2001 so much worse than the historic norm? According to the authors of the new study, the wealth destruction was concentrated among the biggest deals. During the period, some 87 deals—just over 2% of the total—each destroyed over $1 billion of acquiring-shareholder wealth. By contrast, the remaining deals on average created wealth for both sellers and buyers.

Strikingly, many of the big-loss deals were paid for in part with the buyers' own equity. They may thus, say the three economists, have been buying in order to exchange over-valued equity for real assets. That suggests, at least for the shareholders of some acquirers, that value was not being destroyed in the long term. Managers of over-valued firms may also have used the freedom conferred by high equity prices to make deals that they would not otherwise have done.

Mergers often occur in waves. A recent study by Boyan Jovanovic and Peter Rousseau** notes a “monopolisation wave” at the end of the 19th century; a “scale-economies wave” in the 1920s; a “decade of greed wave” in the 1980s; and a “globalisation wave” starting in the late 1990s. Waves often coincide with technological shocks, the two economists note, such as electrification in the 1920s or, indeed, the internet more recently. That may be why, despite paying premium prices, some acquirers still manage to create value. They take advantage of the opportunities afforded by the technological change.

But merger waves also tend to coincide with periods when share prices are high and, arguably, over-valued. The equity bubble in 1998-2001 may have been in some part responsible for the large number of value-destroying mergers at that time. The recent revival in merger activity has coincided, worryingly, with the return of share prices to levels that some think irrationally exuberant.

Other recent studies suggest that, the big disasters of 1998-2001 aside, the value created by merger activity may actually have been underestimated by economists. A new paper by David Hirshleifer and others† argues that the way most previous studies measure value creation is less than perfect. The study, which examines deals in America in 1962-2001, makes various adjustments to take account of the flaws and concludes that mergers created, on average, combined gains to shareholders of 7.3%, compared with the gains identified by the old method of 5.3%. As Mr Hirshleifer says, “this difference may not sound like much, but it is worth many billions of dollars”.

Within this overall story, there are important sub-plots. First, the value created by takeovers has been almost twice as large when there has been more than one bidder. This may be because obvious opportunities to create value are more likely to attract several would-be buyers. Secondly, the value creation has been bigger for mergers within the same industry than for diversifying acquisitions. So, as CEOs set out on their hunt for takeover targets, they should not stray too far from home. And if they are the only hunter for any particular target, they should perhaps ask themselves why.

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* “Wealth destruction on a massive scale? A study of acquiring-firm returns in the merger wave of the late 1990s”, by Sara Moeller, Frederik Schlingemann and René Stulz, *Journal of Finance*, forthcoming.

** “Mergers as reallocation”, by Boyan Jovanovic and Peter Rousseau, NBER working paper, October 2002.

† “Do tender offers create value? New methods and evidence”, by Sanjai Bhagat, Ming Dong, David Hirshleifer and Robert Noah, Fisher College of Business working paper, February 2004.

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Banks

The coming storm

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From The Economist print edition

Corbis

With markets apparently safer, banks are trading ever-greater amounts in search of higher returns. Expect trouble

IN THE autumn of 1998, at a conference organised by Credit Suisse First Boston in—appropriately enough—Monte Carlo, Allen Wheat, then head of the investment bank, stood up after dinner and delivered a breathtaking *mea culpa*. Some sort of apology certainly seemed in order given the huge sums the bank had just lost from extravagant gambles on the Russian economy in particular and financial markets in general. The bets went spectacularly wrong after Russia defaulted, financial markets went berserk, and Long-Term Capital Management (LTCM), a very large hedge fund, had to be rescued by its bankers at the behest of the Federal Reserve. CSFB eventually admitted to losses of $1.3 billion. Before the end of this year, the bosses of many big banks may face the same unpalatable task which confronted Mr Wheat if, like him, they have the courage to admit their mistakes.

The reason is simple: the size of banks' bets is rising rapidly. This is because returns have fallen as fast as markets have risen. Yields on corporate debt of all types, for example, have fallen dramatically, and commissions for all sorts of businesses have also dropped. So banks are having to bet more of their own money to continue generating huge profits. But the amount that they have put on the table in recent months has become worryingly large.

So large, indeed, that the present situation “is not dissimilar” to the one that preceded the collapse of LTCM, says Michael Thompson, a strategist at RiskMetrics, a consultancy that specialises in the kind of risk-management models employed by the banks themselves. Like LTCM, banks are building up huge positions in the expectation that markets will remain stable. They are, says Mr Thompson, “walking themselves to the edge of the cliff”. This is because—as all past financial crises have shown—the risk-management models they use woefully underestimate the savage effects of big shocks, when everybody is trying to get out of their positions at the same time.

Even the banks themselves admit that they are taking bigger risks. Though they do not divulge the size of their positions, or in which markets they are concentrated, how much those positions have grown can partly be gleaned from what they have to report in their financial statements.

So-called value-at-risk (VAR) models determine the amount of capital that banks must set aside against their trading positions, and purport to show how many millions of dollars a bank might lose should

markets turn against it. Banks report this figure. If a bank's VAR is rising, it is taking more risk—and VARs have been climbing for nearly every bank active in financial markets (see chart). The VAR at Goldman Sachs, which these days is widely viewed on Wall Street more as a hedge fund than a bank, has more than doubled in recent years. One of the bank's senior traders was even told recently that he must take still more risk.

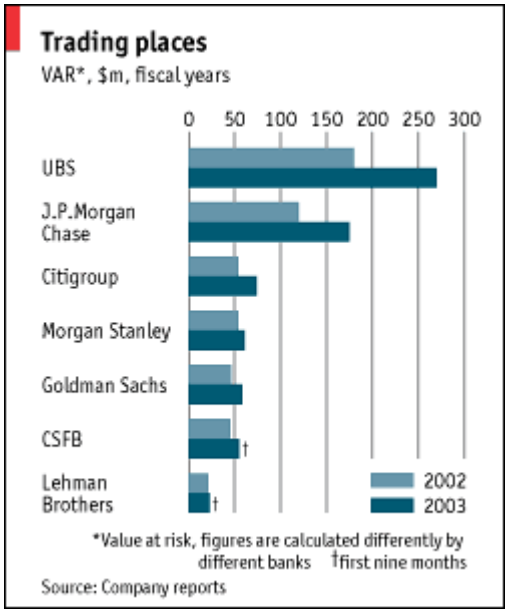
Rest assured that he is far from the only one being told this at Goldman Sachs, or anywhere else for that matter, even though it was only a few years ago that many banks specifically eschewed higher-risk trading as a good way to make money. Earlier this month UBS, a big Swiss bank, said that “with markets and investor sentiment starting to improve” it would gradually increase credit and trading risks.

Even Citigroup, which stopped explicitly trading for its own account a few years back, and HSBC, a bank that used to think of trading as rather beneath its dignity, both announced recently that they too are increasing the amount of trading they do with their own money. And Credit Suisse First Boston, having scaled back its own trading after its 1998 debacle, is also now increasing the amount it devotes to trading, though it claims that it will no longer “bet the ranch”. Allied Irish Banks, which has had more than its fair share of trading fiascos—losing nearly $700m in 2002 thanks to the activities of John Rusnak, one of its foreign-exchange traders—is trying to hire another 20 traders in Dublin.

VAR crash

Of itself, VAR provides a conservative guide to the huge size of banks' current positions. In simple terms, these models assess the amount of risk that a bank is taking by looking at the volatility of the assets it holds and the correlation between them (the less correlation the better). In that way, banks can see how much they might lose were these bets to sour. Crucially, if markets become less volatile, banks can pile on more positions and still have the same VAR. With the exception of Treasuries, markets have indeed become much less volatile—volatility has halved at least in many markets in the past year-and-a-half. Equity markets are now less volatile than they have been for almost a decade. Roughly speaking, if markets are half as volatile, banks' positions can be twice as large for the same amount of capital. But since VARs have in fact risen, some banks' positions are probably three times what they were in the autumn of 2002.

In fact the situation could be still worse. For banks have been increasing their trading exposures in other ways, too. The most notable is via direct investments in hedge funds, often those set up by traders who used to work for the banks themselves. Chemical Bank, now part of J.P. Morgan Chase, started the trend 15 years ago. Now, almost all big banks invest their own capital in hedge funds.



Citigroup may have shut down its “proprietary” trading operations five years ago (temporarily, it now transpires) but it invested a few hundred million dollars of its money in a hedge fund set up by the traders that ran the bank's proprietary trading. Earlier this month, Deutsche Bank leaked that it was also investing $1 billion in a hedge fund run by its erstwhile traders. J.P. Morgan Chase is thought to be the most generous in doling out its cash, but Credit Suisse, Goldman Sachs, Lehman Brothers, and BNP Paribas together invest hundreds of millions of their shareholders' money in hedge funds.

In total, banks have invested many billions of dollars in such funds. The reason, apart from an understandable desire to invest money with good traders, is that the money that is invested in this way is counted as an investment not as a trading position, and so is not included in the banks' own trading books. Most of the money that banks invest has gone into hedge funds that specialise in bonds and other sorts of fixed-income instruments. Like the banks, hedge funds have been leveraging up their exposures to markets.

This activity is splendidly profitable, as long as markets behave themselves. But the strategy puts banks and hedge funds alike at huge risk if markets suffer a severe shock—a far more common occurrence than banks allow for. Their models (and, yes, hedge funds use VAR models as well) assume a certain level of losses for moves of a given magnitude. The problem comes for the tiny number of crises when markets

move much more and, to add insult to injury, banks' assumptions about the diversity of their portfolios are shown to be wrong. In other words, the models, says one regulator with a chuckle, are of least use when they are most needed.

By regulatory fiat, when banks' positions sour they must either stump up more capital or reduce their exposures. Invariably, when markets are panicking, they do the latter. Since everyone else is heading for the exits at the same time, these become crowded, moving prices against those trying to get out, and requiring still more unwinding of positions. It has happened many times before with more or less calamitous consequences.

It could well happen again. There are any number of potential flashpoints: a rout in the dollar, say, or a spike in the oil price, or a big emerging market getting into trouble again. If it does happen, the chain reaction could be particularly devastating this time. Banks and hedge funds have increased their exposures most to those markets that they are least able to withdraw from. Think, if you will, of the extraordinary rise in the price of emerging-market debt and junk bonds. “I used to sleep easy at night with my VAR model,” said Mr Wheat in his speech more than five years ago in Monte Carlo. Suffice to say that he suffered a sleepless night or two when that model was found wanting—and that many a bank boss could be in for the same.

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Currency hedging

Holding back the flood

Feb 19th 2004
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Companies are increasingly protecting themselves against the dollar's fall

Get article background

GRAVITY continues to take its toll on the dollar. This week the euro broke through $1.29, a new lifetime high. Sterling hit a 11-year high of $1.91. The strength of these currencies should be showing up in prices of European-made goods in America: dearer cars, wine and cheese. It should also help to reduce America's massive trade deficit, and perhaps even push up inflation.

But this long-overdue adjustment is happening more slowly than many expected, apparently because of two things. The first is that European firms have so far absorbed, in the form of lower profits, some of the euro's rise. This will not continue forever. But another intriguing reason was suggested by Alan Greenspan in his latest congressional testimony: firms have increasingly hedged their currency exposures. Marvellous though this may be for individual firms, such activities may be delaying the adjustment—and would mean that the dollar will fall even further than it would have done to correct America's current-account deficit.

A striking thought, but is it true? Certainly, the volume of currency derivatives (such as forwards, options and swaps) has risen sharply over the past year. According to the Bank for International Settlements, the only organisation that crunches decent if infrequent numbers, their total value rose 24% in the six months to June 2003—and the value of outstanding currency options surged by a third. But it is unclear from these statistics how much of this activity, if any, is from companies.

More than there used to be, anecdotal evidence suggests. Paul Meggyesi, an analyst at J.P. Morgan Chase in London surveyed two-dozen big European companies. Last May, they had protected about a month's worth of dollar receipts for the rest of that year. By December, they had protected more than half of the dollar revenues for this year.

The reason for their conversion to hedging is not hard to divine: adverse foreign-exchange movements can have a huge impact on profits. Last year, Volkswagen, which sells a lot of cars in America, blamed a fall in profits of more than €1 billion ($1.3 billion) on the fall in the dollar. Porsche has hedged all of its expected dollar revenues until 2007.

A blissfully easy strategy, but only with hindsight. Hedging as comprehensively as Porsche does can also be risky for any company in a market where demand is less sticky than for the iconic cars. If the dollar continues to fall, great. But if it turns around, their profits would be lower than they would have been if they had not hedged. Sometimes doing nothing is more acceptable than doing the wrong thing. Do not expect hedging to delay the adjustment too long.

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Trade and Africa

Emerging deals

Feb 19th 2004 | JOHANNESBURG
From The Economist print edition

Seeking a friend in South Africa

“AFRICA is important to the future of the United States” Robert Zoellick reassured his hosts in Cape Town this week. Was America's trade representative just being polite? Though Africa accounts for barely 2% of world trade, Mr Zoellick is giving it some serious attention in his two-week world tour. After Cape Town he flew to Kenya. Another American trade team is in Namibia next week. Mr Zoellick hopes to sign a trade deal this year with southern Africa, which could be expanded to other bits of the continent.

Negotiations for a trade deal between America and the Southern African Customs Union (SACU, composed of South Africa, Botswana, Lesotho, Namibia and Swaziland) began a year ago, but start in earnest on February 23rd. Mozambique is expected to apply to join SACU; others may do so once a deal is done.

The Africans' interest is to guard preferential export rules enshrined in the temporary African Growth and Opportunity Act, passed by Congress in 2000. Tariff-free exports of some 6,000 goods from Africa to the United States are boosting trade and investment in southern Africa. Lesotho's fast-growing textile industry depends almost entirely on Chinese investment in factories to make clothes for sale in the United States. The region also wants more access to America's markets for fruit, beef and other agricultural goods.

American interest lies mainly in South Africa, by far the largest economy in the region. Services account for 60% of its GDP, and increasingly dominate the rest of Africa in banking, information technology, telecoms, retail and other areas. Just as British banks, such as Barclays, have moved their African headquarters to South Africa over the past year, American investors see the country as a platform to the rest of the continent.

Agreeing investment rules and resolving differences on intellectual property rights are the most urgent issues. American drugs firms want to be part of the fast expansion in South Africa of production of anti-retroviral drugs, used against AIDS. By 2007 South Africa alone expects 1.2m patients to take the drugs daily. The country might be the world's biggest exporter of anti-AIDS drugs within a few years. Striking a bilateral deal now should make American investments easier.

But Mr Zoellick's greater concern is for multilateral trade talks that stalled in Cancún, Mexico, in September. Alec Erwin, his South African counterpart, helped to organise the G20 group of poor and middle-income countries that opposed joint American-EU proposals there. He is widely tipped to take over as head of the World Trade Organisation late next year, and would be a useful ally.

So Mr Zoellick is trying to charm his African partner by agreeing to drop support for most of a group of issues (known as “Singapore” issues) that jammed up the talks at Cancún, and were opposed by poor countries. He says he also favours abolishing export subsidies in America—though only if Japan and the EU agree to do the same. That would please African exporters who say such subsidies destroy markets for their goods.

Mr Zoellick's efforts to make more friends may be paying off. Even though America has treated Africa very shabbily on trade in the past, Mr Erwin hints it is easier doing business with America than with Europe or Japan. A small sign, but perhaps a telling one.

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Japan's economy

Surprise, surprise

Feb 19th 2004 | TOKYO
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Japan grows its fastest in a decade

Get article background

EVERYONE knew that the economy was gaining speed, but Japan's latest growth figures were even better than optimists had hoped for. In the fourth quarter of last year, Japan's real GDP grew at an annual rate of 7.0%, its fastest since 1990, and by 2.7% for the year as a whole. Equally heartening, nominal GDP—ie, before adjusting for the "flattering" effects of deflation—grew by 2.6% at an annual rate in the final quarter. Nominal GDP last year was a bit higher than the year before.

Quite probably, the pick-up can last. Growth in the present quarter may not be quite as exuberant as it was in the last, and the latest figures may yet be revised down. They suggest, for example, that prices fell at a 4.4% annual rate in the fourth quarter, which is hard to believe given that all other indicators suggest that deflation is moderating. Whatever the reason, if deflation is overstated, then so too is the real growth rate. But even real growth of 5% rather than 7% would be very encouraging.

And it now seems broad-based enough to carry on at a good clip for a while yet. For the most part, even pessimists now reckon that solid growth will continue at least until the middle of this year. Unlike past upturns, this one has not been based only on government pump-priming, or exports to America. Instead, it has been driven by a healthy balance of private domestic demand and global exports.

Firms' profits and investment are booming—and even consumers show signs of loosening their purse strings a bit. Broad exports have played a big role in the rebound, growing nearly 10% last year and by almost a fifth at an annual rate in the fourth quarter. Bumper overseas sales of electronics equipment, such as digital cameras and DVD players, have helped. Although the yen rose 12% against the dollar in 2003, it fell sharply against the euro, boosting exports to Europe.

Demand from China is growing rapidly, and overall foreign orders for Japanese machinery were their second-highest ever in December, growing by 61% compared with the previous year. Such heady demand means that Japanese equipment makers will continue to crank up output.

Arguably, growing demand from domestic companies is more encouraging still, because it reflects Japanese firms' optimism about their own economy. Last year, business investment rose 8.8%, after dropping the year before. And demand accelerated in the fourth quarter, when business investment grew by more than a fifth at an annual rate.

How far all this demand curbs deflation is another matter. Most economists dismissed the extraordinary deflator in the GDP numbers as yet another cock-up by Japan's bean-counters. Signs are there for all to see that deflationary pressures are easing. Consumer-price deflation has been moderating. Producer prices were flat in the year to January—the first time since 2000 that inflation was not negative.

Many economic pundits are betting that reduced deflation will give way to healthy inflation by next year or the year after, so long as the Bank of Japan sticks to its expansionary monetary policy. Next month, the finance ministry will issue bonds indexed to changes in consumer prices—allowing the world to see if bond investors, who have been bearish on Japan for very many years, agree with such heady optimism.

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Retail banking

Branching out

Feb 19th 2004 | NEW YORK
From The Economist print edition

Infatuation with retail banking grows, even as its economics grow suspect

The future of banking

THE hottest area in American banking is the humble, once-derided branch. Bank of America, Washington Mutual and Citibank are all building lots of new branches. Thousands more are being built by other banks. Those who can not build fast enough are buying. Two big acquisitions of retail banks this week followed another at the end of January. On February 16th, North Fork Bancorp, a middling retail bank in expansionary mood, paid $6.3 billion for GreenPoint Financial. A day later National City, the largest bank in Ohio, announced that it would buy Provident Financial for $2 billion. Sadly, the customers they are trying to attract may already be walking out of the door.

North Fork Bancorp's purchase of GreenPoint Financial will add 90 branches to its New York network, bringing its total to 261. Another 70 will be added once a previously announced $800m acquisition of Trust Company of New Jersey is completed. And by buying Provident Financial, National City will add 65 branches to the 1100 it has already. So many new branches are opening up in city business areas that in Chicago there are worries about lost sales taxes from stores that have been displaced.

The current popularity of branches seems odd. For most of the 1990s banks replaced branches with automatic teller machines (ATMs), call centres, and internet banking. Banks' funds were increasingly obtained in the markets. Large banks were shrinking existing branches by 2% a year, after adjusting for acquisitions.

Why the renewed enthusiasm? The financial panics that followed the popping of the bubble were one reason. Because banks could no longer rely on cheap funds from capital markets, they again began chasing individual depositors. As a result, bank bosses have opened up new branches as quickly as they could move in furniture. Moreover, retail banking has seemed more attractive than investment banking of late. Banks have made pots of money from their branch networks, which have pulled in low-cost funds and bumper fees from mortgage refinancings. The price of shares in retail banks has soared. Those in Provident and GreenPoint have risen by two-thirds or so over the past year.

Alas, at the same time as investors' enthusiasm rises for banks that are putting ever more money into their branches, customers seem to be taking their dollars out. Deposits have stopped growing and may even be falling. Michael Mayo, a bank analyst at Prudential Securities, says that data from the banks themselves and from the Federal Deposit Insurance Corporation shows that there was an unusually pronounced reduction in deposits in the fourth quarter of last year.

Part of the reason for pulling money out is renewed faith in the markets. A savings account guaranteed by the government looked comforting when shares were falling and regulators were swarming over brokers and mutual funds. Money also went into deposits because of a quirk in mortgage refinancing rules, which require borrowers to open special accounts while their loans are processed. But Americans now have more faith in shares. And mortgage refinancings, which have already slowed, seem likely to fall further as a recovering economy eventually pushes up long-term rates.

Branches are a fixed cost, and fewer deposits mean less revenue to cover them. For some banks, this loss will be offset by the sale of other products. But with each new branch comes more competition. The

results of previous periods of manic branch building have made lovely restaurants. Their more modest successors will doubtless make nice coffee bars.

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European inflation

A stubborn, taxing problem

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Governments' attempts to boost revenues keep inflation high

STICKY. Obdurate. Stubborn. Inflation in the euro area has been called all these things. Despite slow growth and low interest rates, it has remained stuck above the European Central Bank's (ECB) target of below 2% for the past six months. Some economists think that January's revised inflation figures will at last show it falling below the magic number. But even if this happens, why has it taken so long?

When economies slow, firms come under pressure to cut their prices. But governments, facing disappointing tax revenues, come under pressure to hike indirect taxes and charge more for public services, such as rubbish collection or health care. France and Portugal have raised taxes on tobacco recently. Germany has raised the price of health care. All such measures feed into the cost of living. Thus, even as their straitened economies cry out for looser money, European governments are reinforcing inflation, making an interest rate cut by the ECB less likely.

In its latest monthly bulletin, the ECB tries to work out how much indirect taxes and administered prices add to euro-area inflation. It points out that tobacco prices in November last year were 11.6% higher than in the previous November, adding 0.25 percentage points to that month's inflation rate of 2.2%. In short, were it not for the rising cost of smoking, the ECB would have hit its inflation target.

The bank also looks at a range of prices that are often set by administrative fiat rather than market forces. These “administered prices” cover sewerage and rubbish collection; medical, dental and hospital care; the post; trains; education and social protection. Wise governments administered them upwards at the rate of 3% per year last year, much faster than inflation overall. In some months of 2003, these prices added almost 0.2 percentage points to the headline rate of inflation.

There may be many reasons why tobacco taxes and “administered prices” have risen so steeply in recent quarters. European governments no doubt care deeply about their citizens' blackened lungs, not just their own red-inked budgets. But if the ECB were to see through these hikes to the rather slower rise in market prices—to pay more attention, in other words, to its own research—it might be tempted to cut rates and stimulate growth. Government revenues would rebound, and taxes and charges might remain on hold. Even Europe's beleaguered smokers could puff away without worrying so much about the cost.

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Economics focus

Wirtschaftsblunder

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Why has the German economy performed so much worse than the rest of Europe?

Over the past ten years, Germany's GDP has grown by an annual average of only 1.4%, barely half as fast as growth in the rest of the European Union, and roughly the same pace as Japan, which has been a byword for slow growth over the past few years. The most popular explanations for Germany's dismal performance are the costs of reunifying East and West Germany, and the arthritic state of the united country's labour markets. However, a new study* by Goldman Sachs, an investment bank, makes an intriguing claim: that it is an artificially low cost of capital, which has encouraged excessive investment, that has been most to blame. A rising cost of capital in recent years can explain much of Germany's weaker growth—and could continue to depress it for several more years.

The study starts with Germany's extraordinarily low return on capital. Goldman Sachs estimates that German firms have earned an average pre-tax rate of return on their capital of only 5% since 1991. In contrast, the average return in the rest of the EU has been 12% which, as the chart shows, is even higher than the 10% earned by American companies. Reunification has been partly to blame: the inclusion of firms in former East Germany and the massive boom in capital investment after unification both depressed average returns. But eastern Germany is only 11% of total GDP—too small to explain the unusually low overall average rate of return. In any case, firms in West Germany already had a low return on capital before reunification.

Some argue that Germany's powerful trade unions have raised wages and so reduced the return on capital. But unions are as strong and labour markets as rigid in other EU countries where returns are higher. Moreover, if trade unions had increased workers' total income, the consequent lower return on capital should have reduced investment. Yet quite the opposite has been true: since 1991 business investment has averaged 21% of GDP in Germany, 18% in the rest of the EU and 15% in America.

The combination of high investment and low returns, says the bank, suggests that the cost of capital has been much lower in Germany than elsewhere. Firms invest up to the point at which the extra return covers the cost of capital plus a profit margin. If capital costs are held down, the result is high investment and low returns. It is Germany's capital market, not its labour market, that sets it apart from other European economies. But in important (and worrying) respects this makes the country similar to Japan, where investment as a proportion of GDP is also very high, and returns on capital are correspondingly low.

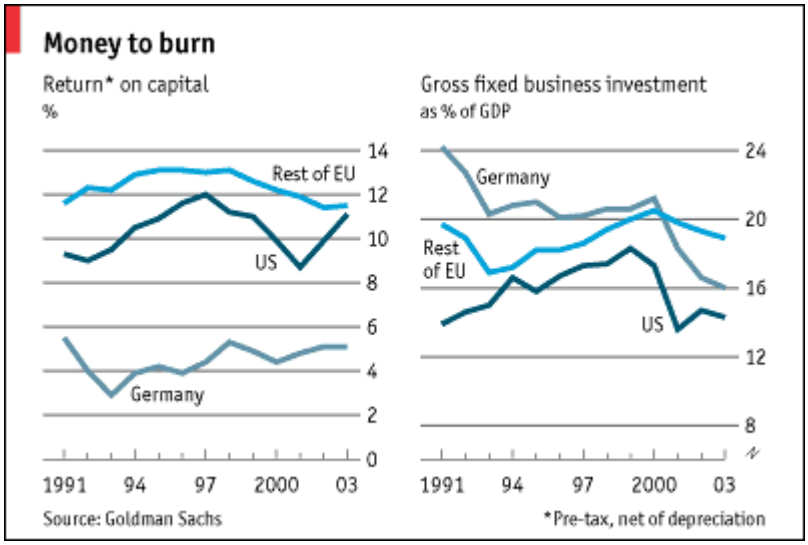
Germany's financial system is distinctive in two important ways. First, firms rely much more on banks than financial markets. Bank debt accounts for half of the liabilities of non-financial firms, twice the share in the rest of Europe. Second, state-owned financial institutions (Landesbanks and savings banks) account for a big chunk of corporate borrowing. Debt issued by state-owned banks is guaranteed by the government, reducing their financing costs and hence their lending rates. Moreover, they were set up explicitly to assist the expansion of local business, so their objective has been to support investment not maximise returns. Small wonder that German banks' average return on equity is half that of banks in the rest of the EU.

Capital crunch

With borrowing cheap—their cost of capital was at least two percentage points lower than in the rest of Europe in the late 1990s—German firms invested more. But private-sector banks are now under pressure from shareholders to boost profits and in 2001 the European Commission ruled that public guarantees for

state-owned banks were anti-competitive and must be phased out. The result is that firms' risk-adjusted cost of capital will rise to more normal levels. Indeed, the interest rates paid by many German firms have already risen in recent years, even as official rates have fallen.

According to Goldman Sachs, it is this rising capital cost that is largely to blame for Germany's weak investment and slow growth in GDP in recent years. Investment as a share of GDP has fallen from 24% in 1991 to 16% in 2003. It may well fall further, because corporate borrowing costs are still lower than in the rest of Europe, and it will take a long while for firms to adapt to paying more for their money. In Japan, where a low cost of capital similarly caused over-investment in the past, investment and growth have been depressed for more than a decade.



Making various assumptions, Goldman Sachs estimates that, if the average cost of capital in Germany rises to the European average, this could eventually reduce Germany's GDP by 5%. In other words, it could knock half a percentage point off its annual growth rate over ten years. And the country, reckons the bank, is only half way through that process.

In the long run, capital-market reform will lead to a more efficient use of capital, and hence higher rates of return. Indeed, total national income (including foreign income), in contrast to GDP, should increase. As the capital subsidy is eliminated, more money will be invested abroad as firms seek higher returns, making Germans as a whole better off. But for the economy to benefit, the labour market will need to adjust quickly because the shift of capital overseas will otherwise result in job losses.

So even if capital costs are the main source of Germany's sluggish growth, labour-market reform is still important because it would reduce the short-run loss of output as firms adjust to higher borrowing costs. Indeed, if labour costs can be squeezed by reforms, firms can adjust without having to cut investment as much. The snag is that, even if Germany pushes ahead with labour reform, rising capital costs will continue to constrain investment and growth. And with no immediate benefits, public resistance to reform in general is likely to grow.

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* “No gain without pain—Germany's adjustment to a higher cost of capital”, by Ben Broadbent, Dirk Schumacher and Sabine Schels. Global Economics Paper No. 103

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Oceanography

From black box to blue box

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Corbis

The American Association for the Advancement of Science (AAAS) has just held its annual meeting. One highlight was a session on new techniques for tracking marine animals

MAKING a living as a fisherman has never been easy. With the continual decline in fish stocks currently under way, it is becoming an even harder way to grind out a living. And it is not only fish that are disappearing, but marine fauna generally. In the past 20 years, for example, 90% of leatherback turtles and large predatory fish, such as sharks, have disappeared.

Where and how this is happening has been difficult to say, since the ocean is something of a black box. Things go in, and things come out, but what happens in between is hard to unravel. According to researchers presenting their work at the AAAS meeting in Seattle, Washington, this is now changing. Today, when many marine biologists swig their morning coffee and download their messages, they receive special e-mails from their research subjects. These messages, relayed by a satellite, tell them exactly where their animals have been. This has been made possible thanks to advances in underwater electronic tagging, and it is causing a revolution in marine biology.

One of the leading researchers in oceanic tagging is Barbara Block of Hopkins Marine Station in Pacific Grove, California. She tags bluefin tuna, which are commercially valuable animals that can reach 680kg (1,500lb) in weight, and swim at speeds of up to 80kph (50mph). So far, her group has tagged around 700 bluefin. Many of the tags are surgically implanted, a tricky thing to do while on board a moving boat. These tags archive their data in memory chips, and are eventually recovered when a fish is caught and butchered. (The tags carry a healthy reward.) Other tags, though, are fastened to the outside of a fish, and pop off at a pre-programmed time and date. They then broadcast their results to a satellite. Dr Block's work has shown that bluefin can migrate thousands of kilometres across the Atlantic, ignoring boundaries that have been set to protect stocks in the western Atlantic.

Thanks, and so long to all the fish

Tagging is also helping David Welch, the head of the Canadian government's salmon programme, to find out where and why large numbers of the fish are vanishing. He uses small acoustic tags (the size of a large multivitamin capsule) that are sewn into the body cavities of salmon. These tags broadcast their signals to microphones on the seabed.

Dr Welch can now track where an individual salmon spends its life and watch trends in an entire population. He was surprised to find that most salmon do not die as they leave the river and enter the sea, as previously believed. And he is finding that climatic fluctuations play an important role in determining population.

Dr Welch and his colleagues are planning to install a system of microphones stretching from the coast of Washington state to south-eastern Alaska. This could follow the movements of some 250,000 fish—collecting data on their direction of travel, speed, depth and position. If that works, the plan is to extend the system from Baja California in Mexico to the Bering Sea—a project that would involve about 1,000 underwater tracking stations.

Meanwhile, Andrew Read, a marine biologist at Duke University in North Carolina, is following 45 tagged loggerhead turtles. These animals must come to the surface to breathe. When they do so, the tags (which are glued to their shells) talk to the nearest convenient satellite.

Dr Read told the meeting that the tracking data he collects are now available online, to allow fishermen to follow the movements of turtles and, if they wish, to modify the deployment of their nets accordingly. Bill Foster, a fisherman from Hatteras, North Carolina, and Dr Read, proposed the project because the Pamlico Sound near Hatteras was closed to large-mesh gill nets (which are dragged behind a boat like a curtain) for four months a year because too many turtles were being caught by accident. Now, the fishermen are helping the researchers, and attaching tags to healthy turtles that are accidentally caught in their nets.

Together, all this work is beginning to fill in the map of marine “highways” used by particular species, and their preferred habitats. It is also showing where particular animals prefer to stay close to the surface, and where they prefer deeper waters. As in the case of Dr Read's turtles, this is helping scientists to devise ways of protecting rare species in an efficient manner, without interfering too much with the exploitation of common ones.

Larry Crowder, also at Duke University, has overlaid maps of marine highways for loggerhead and leatherback turtles in the Pacific on to those of “longline” fisheries, in which people catch prey on fishing lines that are several kilometres long. Turtles often take the bait on the hooks that these lines carry. Dr Crowder wants to identify the places of greatest danger to these turtles, in the hope that such places will be considered for protection. This need not, he says, mean a ban on fishing, but rather the use of different hooks, and other sorts of gear that are less damaging to turtles. It also turns out that turtles spend 90% of their time within 40 metres of the surface, so setting hooks deeper than this would reduce the chance of catching them accidentally.

Conservationists are now pushing the notion of “ocean zoning”. Like the land, parts of the sea—such as turtle highways—would be defined as sensitive, and subject to restrictions on how extractive industries operate. If this idea is ever to work, tagging data will be crucial. And because tagging data come in continually, this could mean that sensitive areas in the ocean could be flexible, changing in both time and space. Enforcing such zones might be difficult. But it would help fish, and other marine fauna, breathe a bit easier. And careful management might leave the fishermen on top as well.

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The origins of language

Signs of success

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Deaf people are making a profound contribution to the study of language

Ann Senghas

We all speak smile

JUST as biologists rarely see a new species arise, linguists rarely see a new language being born. You have to be in the right place at the right time, which usually you are not. But the past few decades have seen an exception. Linguists have been able to follow the formation of a new language in Nicaragua. The catch is that it is not a spoken language but, rather, a sign language which arose spontaneously in deaf children. Ann Senghas, of Columbia University, in New York, one of the linguists who has been studying this language, told the AAAS conference in Seattle about her discoveries. And Susan Goldin-Meadow, of the University of Chicago, who studies the spontaneous emergence of signing in deaf children, filled in the background by showing how such children use hand signals in a different way from everybody else.

The thing that makes language different from other means of communication is that it is made of units that can be combined in different orders to create different meanings. In a spoken language these units are words. In a sign language these units are gestures. Dr Senghas has been studying the way those gestures have evolved in Nicaraguan Sign Language (NSL).

The language emerged in the late 1970s, at a new school for deaf children. Initially the children were instructed by teachers who could hear. No one taught them how to sign; they simply worked it out for themselves. By conducting experiments on people who attended the school at various points in its history, Dr Senghas has shown how NSL has become more sophisticated over time. For example, concepts that an older signer uses a single sign for, such as rolling and falling, have been unpacked into separate signs by youngsters.

Early users, too, did not develop a way of distinguishing left from right. Dr Senghas showed this by asking signers of different ages to converse about a set of photographs that each could see. One signer had to pick a photograph and describe it. The other had to guess which photograph was being described.

When all the photographs contained the same elements, merely arranged differently, older people, who had learned the early form of the language, could neither signal which photo they meant, nor understand the signals of their younger partners. Nor could their younger partners teach them the signs that indicate left and right. The older people clearly understood the concept of left and right, they just could not converse about it—a result that bears on the vexing question of how much language merely reflects the way the brain thinks about the world, and how much it actually shapes such thinking.

For a sign language to emerge spontaneously, though, deaf children must have some inherent tendency to tie gestures to meaning. Spoken language, of course, is frequently accompanied by gestures. But, as a young researcher, Dr Goldin-Meadow suspected that deaf children use gestures differently from those who can hear. In a 30-year-long project carried out on deaf children in America and Taiwan, whose parents can hear normally, she has shown that this is true.

Even deaf children who have no deaf acquaintances use signs as words. The order the signs come in is important. It is also different from the order of words in either English or Chinese. But it is the same, for a given set of signs and meanings, in both America and Taiwan.

Curiously enough, the signs produced by children in Spain and Turkey, whom Dr Goldin-Meadow is also studying, while similar to each other, differ from those that American and Taiwanese children produce. Dr Goldin-Meadow is not certain why that is. However, the key commonality is that their spontaneously created languages resemble fully-formed languages.

That result, if confirmed in other studies, could have profound implications. Another much-argued question in linguistics is whether there is some sort of grammatical template that acts as part of a language instinct and is wired into the brains of new-born children. Such a template would help a child to learn a language quickly. But the different grammars of actual languages suggest it cannot, assuming it does exist, be imposing itself too strongly. However, the sign languages of Dr Goldin-Meadow's children are entirely self-invented. If there is a deep structure, they are surely drawing on it directly. The order of their signs may thus be a direct reflection of what that structure is.

For now, Dr Goldin-Meadow is cautious. But it may turn out that the truth comes not out of the mouths of babes and sucklings, but from their hands.

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About sponsorship

Dog behaviour

Sensitive souls

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How dogs became man's best friend

NO SPECIES has developed a closer relationship with humanity than the dog. (Though cat-lovers may disagree.) But that relationship's basis—what it is about dogs that allows them to live at ease with people—is still little understood. After all, dogs are descended from wolves, which are big, scary carnivores that would certainly have competed with early man for prey, and might not have been averse to the occasional human as a light snack.

Unless specifically bred for fighting, dogs are more docile than wolves, so that is clearly part of the answer. But mere docility cannot account for why people like to have dogs in their homes. Sheep are docile, but few people keep them as pets.

Brian Hare, of Harvard University, thinks he knows. And, as he told the AAAS meeting in Seattle, it does not reflect well on the intelligence of mankind's closest living relative, the chimpanzee. Dr Hare's hypothesis is that dogs are superbly sensitive to social cues from people. That enables them to fit in with human society. On one level, this might sound common sense. But humans are such sociable animals that they frequently fail to realise just how unusual are their own skills at communicating. Dr Hare therefore decided to test his idea by comparing the abilities of dogs with those of chimpanzees, which are often regarded as second only to people in their level of innate intelligence.

His experiment was simple. He presented his animal subjects with two inverted cups. Then he hid the cups behind a screen, put a small piece of food under one of them, and took the screen away. The animal had to choose which cup to look under. If the experimenter gave no cue, both species got it right 50% of the time, as would be expected. However, if he signalled in some way which was the right cup, by pointing at it, tapping it, or even just gazing at it, a dog would choose correctly every time, while a chimpanzee would still do only slightly better than chance. Chimps simply did not get the idea of social signals of this sort, however many times the experiment was repeated.

Having established, to his own satisfaction at least, that his hypothesis was correct, Dr Hare asked the next logical question—how did this skill originate? He had three more hypotheses.

The first was that it was a carry-over from dogs' lupine ancestors. Wolves are also sociable creatures, so this sounded a likely idea. But it turned out that wolves are no better than chimpanzees at working out where the food is hidden.

The second idea was that social sensitivity is a skill that dogs learn by being around people. That, too, was wrong. Dr Hare tried his version of the cup game on dogs that had been reared in kennels with minimal human contact, and on dogs that had been raised as part of human families in loving homes. There was no difference between them.

The third idea was that sensitivity to human social cues is a recent genetic adaptation that has evolved specifically to allow dogs to enter a new ecological niche—that of being symbiotic with people. Testing this one was tough. But Dr Hare managed it by going to New Guinea.

This island has a population of dogs known as singing dogs, because they cannot bark, but instead yowl in a way some compare to human song. Singing dogs' body shapes are those of other dogs, rather than of wolves, indicating that they may once have been domesticated. Research on foxes in fur farms suggests that such body shapes are a side-effect of breeding for docility. But New Guinea's singing dogs are now completely wild, and the archaeological record suggests that they have been so for thousands of years. That, Dr Hare reasoned, would be long enough for natural selection to eliminate a trait that was

no longer valuable to the animal.

And so it proved. Singing dogs, even if raised from puppyhood by people, were no better than wolves or chimps at find-the-morsel. The conclusion is that what natural selection had taken away from the singing dogs was something that it had first given to ancestral dogs: the ability to understand people's intentions almost as well as they understand each other's.

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Dogs and medicine

Roll over, Beethoven

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Several areas of medical research get a helping hand from hounds

MAN'S proverbial best friends are performing yet another good turn. Not through friendliness, but rather through similarity—as experimental animals in the study of human disease. Two sessions at the AAAS meeting in Seattle showed how illuminating such work can be.

Carl Cotman and his colleagues at the University of California, Irvine, have been using beagles to investigate the effects of diet on the decline of brain function that accompanies ageing. Dogs are a useful stand-in for people in such experiments because the way memory declines in the two species seems comparable. Memory loss in dogs is accompanied by the formation of so-called amyloid plaques in the brain. Rodents, the usual stand-in mammals used in medical research, do not tend to accumulate such plaques as they age. In people, amyloid plaques are one of the symptoms of Alzheimer's disease.

The other reason that dogs are better than mice for this work is that they are able to learn much more complex tasks. Researchers can use this ability to investigate losses of brain function that mice could never show them.

Dr Cotman wanted to know whether a diet rich in antioxidants, such as vitamins C and E, could relieve the symptoms of an ageing brain. Oxidative stress within the brain, which causes the production of molecules known as free radicals, increases with age. Free radicals can damage—and eventually kill—brain cells.

The results astonished the researchers. Not only did the antioxidant-rich diet halt age-related decline, it actually reversed it. While beagles on a normal diet continued to lose their cognitive abilities as they got older, those on the experimental diet showed improvements in learning and memory. These dogs could do much more complicated tasks, and made fewer mistakes. They could also re-learn tasks that they could do when they were younger, but had forgotten. And the diet (which, besides the vitamins, contained two food supplements called alpha-lipoic acid and acetyl-l-carnitine, that help to stop free radicals forming in the first place) also reduced the accumulation of amyloid plaques in the beagles' brains.

Meanwhile, Elaine Ostrander, who works at the Fred Hutchinson Cancer Research Centre, in Seattle, is taking advantage of the superb pedigree records of many breeds of dog to track down the origins of inherited diseases. The publication last year of a preliminary sequence of the canine genome means that it is possible to cross-correlate human and dog DNA. Although it is jumbled up differently, and spread across different chromosomes, most of the DNA in a dog can be divided into blocks that have recognisable counterparts in humans, and vice versa.

Pedigree records mean it is possible to follow maternal and paternal blocks around as they pass from parent to offspring. So, if a particular disease exists in a breed of dog, then a little number-crunching using a computer can track down which block it is in. Comparing the exact DNA sequence of that block in healthy and unhealthy animals should indicate which mutation in the DNA is causing the problem (it will always be found in the animals which have the disease, and never in those which do not). Then it is just a question of identifying the corresponding gene in people, by looking at the relevant human block, and seeing if a similar difference exists between healthy and unhealthy humans.

Not surprisingly, given where she works, Dr Ostrander has applied the method to cancer. In this case it was a kidney cancer called RCND that is a particular problem in German-shepherd dogs. She used the pedigree records of German-shepherd breeders to track the cause down to a gene on dog chromosome 5. The block of DNA this gene inhabits corresponds to one on human chromosome 17 and, lo, the

affected gene turned out to be one that can cause kidney disease in people, too.

Though Dr Ostrander's interest is in cancer, the method should work for any disease that has a genetic component (which most non-infectious diseases do). Given that dogs and people share quite a few diseases, it seems that dog breeders have given science quite a useful tool.

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Mad-cow disease

Oh no, not again

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A new prion disease may have been discovered in cows

SALVATORE MONACO, a researcher at the University of Verona, and his colleagues, have created a stir this week by reporting, in the latest edition of the *Proceedings of the National Academy of Sciences*, what they think is a new prion disease in cattle.

The best known (indeed, until now the only known) prion disease of cattle is bovine spongiform encephalopathy (BSE), or “mad cow” disease. Prion diseases are odd. Although they can sometimes be passed from one individual to another as an infection, they do not appear to be caused by an organism that has genes, unlike all the other infections that are known. Instead, they are caused by misshapen brain proteins (prions) which have the strange characteristic of acting as catalysts that cause normal versions of the protein to reconfigure themselves as prions. Thus the infection spreads and, eventually, kills by affecting critical brain functions.

BSE has proved, in relatively rare cases, to be transmissible to people who have eaten the meat of infected cattle. In Britain, where BSE was first identified, some 139 people have died over the past decade of the human version, known as variant (or, sometimes, new-variant) Creutzfeldt-Jakob disease (vCJD). As the sobriquet suggests, other forms of CJD had been identified in people before vCJD came along. Some had known causes (such as the transplantation of infected tissue), but most were dubbed “sporadic”, and of unknown cause. The reason for the excitement this week is that Dr Monaco's new version of mad-cow disease shares features with one of the human sporadic forms of CJD, and might therefore be its cause.

The new disease is dubbed bovine amyloidotic spongiform encephalopathy (BASE), because it causes the formation in the brain of structures called amyloid plaques. Such plaques form in humans during Alzheimer's disease. They also form in particular patterns in the brains of people who have contracted a certain strain of sporadic CJD, known as M/V2. Those patterns are similar (though not identical) to the ones seen in BASE. And the BASE prion itself resembles the one which causes M/V2 sCJD. In particular, it has fewer sugar molecules attached to it than does the prion that causes BSE and vCJD.

So far, Dr Monaco and his team have found only two cows with BASE, so its identification as a genuinely new disease is far from secure. It could simply be BSE that has developed in an odd way.

On the other hand, it would be strange if cows only had one prion disease, as humans and sheep have several. If it does turn out that BASE is the cause of M/V2 sCJD, that would not be cause for panic. Only one or two people per million are killed each year by all forms of sCJD, a figure that has been stable for years. Those killed by M/V2 sCJD are but a fraction of that already small number.

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Biography

Mary Queen of Scots and her mother-in-law

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Bridgeman/Corbis

A sympathetic reappraisal of two difficult women

ANY writer who spends a year or more in the company of an historical figure is liable to conclude that the subject has been wronged by posterity. Rehabilitation is more difficult if, as in the case of Mary Queen of Scots and her mother-in-law, Catherine de Medici, contemporaries seem to have concurred with the modern view of the pair as unhinged plotters. But John Guy and Leonie Frieda do their best.

The case against Mary Queen of Scots is the weaker one, even though it once seemed strong enough to condemn her. The fledgling monarch lost her liberty in 1567, when she was accused of murdering her second husband. She spent two decades imprisoned in various castles—a boon to the tourism industry, but almost certainly an injustice. Through an ingenious reading of Mary's letters, John Guy proves much of the evidence against her to be forged, and reveals the identity of the forger: William Cecil, the ruthless adviser to Queen Elizabeth I of England.

The same Elizabeth signed Mary's death warrant in 1587. She did so reluctantly, though, and only after her Scottish cousin had become involved in a plot that mixed Catholic uprising and Spanish invasion. To the charge of treason, Mary's biographer pleads guilty with an explanation. The queen had become desperate; the plot was demented and, again, the whole affair was cynically exploited by the English.

Catherine de Medici's reputation is harder to salvage. Like Mary, she was inclined to intrigue—but unlike Mary, she was savagely good at it. Peevish, superstitious and swathed perpetually in black (this in the most exuberant court in Europe), she was more or less involved in the killing of a string of inconvenient courtiers. Even her embalmed corpse proved obnoxious, and she was buried under cover of darkness.

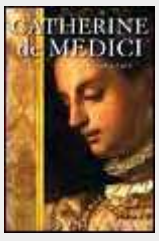
History remembers Catherine mostly as the architect of the appalling St Bartholomew's Day massacre, which ended the hopes of Protestantism in France. Leonie Frieda finds this unfair, although the excuse she provides is almost as

My Heart is My Own: The Life of Mary Queen of Scots
By John Guy

Fourth Estate; 574 pages; £20. To be published in America as "Queen of Scots" by Houghton Mifflin in April

Buy it at Amazon.co.uk

Catherine de Medici: A Biography
By Leonie Frieda



Weidenfeld & Nicolson; 440 pages; £20

incriminating. The queen mother wanted to rub out a few Huguenot noblemen, and foolishly misjudged the mood of the Catholic street.

Buy it at
Amazon.co.uk

Special pleading aside, the biographies do make Mary and Catherine more sympathetic. Both were exiles—Catherine an Italian living in Paris; Mary a Scot removed to France and then, just when she had become accustomed to her new home, cast back into Scotland. Both women were natural moderates in an era of religious extremism. And both were consistently outmanoeuvred by less scrupulous and, frankly, more talented rivals.

Does any of this really matter? It is one thing to burnish a queen's reputation, but what an historical biography ought to do is tell the reader something new about the times in which the subject lived. Miss Frieda's book, despite its clear rendering of the factions afflicting 16th-century France, does not do this. John Guy's book does, and so successfully that a tradition of royal biography is thrown into question.

Mr Guy's innovation is most obvious in his descriptions of royal ceremonies and processions. There were a lot of these in 16th-century Europe, and they did not always go well. Mary's triumphal 1561 entry into Edinburgh, for example, was marred by public drunkenness (too much free wine laid on to pull in the crowds) and by the local Calvinists, who slyly inserted Protestant propaganda into the festivities.

At other times, Mary's handlers managed her public face better. They sent a portrait of the queen to the less beautiful Elizabeth, and produced dinner plates celebrating Mary's supremacy over France and the British Isles—at one point, the English ambassador was served a meal on these plates. So much was spent, and so ostentatiously, that local shopkeepers refused credit to the royal household.

These details do much more than provide historical colour. Together, they show what the monarchy was (and is) about. Public displays of wealth and power, it seems, were not just what royalty did; instead, they were what it was. As the anthropologist Clifford Geertz observed, in a rather different context, “power served pomp, not pomp power.” The intrigues that Mary and Catherine indulged in seem more real to us, who can translate them into modern political terms. But to them, appearance was all.

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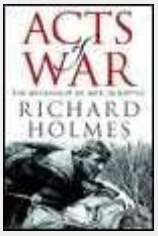
Into battle

The human weapon

Feb 19th 2004
From The Economist print edition

“WAR”, says Richard Holmes, “contains elements of both farce and tragedy.” Based on soldiers' accounts stretching from Napoleonic Europe to the Falklands, and mixed with some sociology and psychology, Mr Holmes dissects every aspect of a soldier's life before and during combat to understand what makes men fight, kill and sometimes long for their fighting days after they land back into civilian life.

Acts of War: The Behaviour of Men in Battle
By Richard Holmes

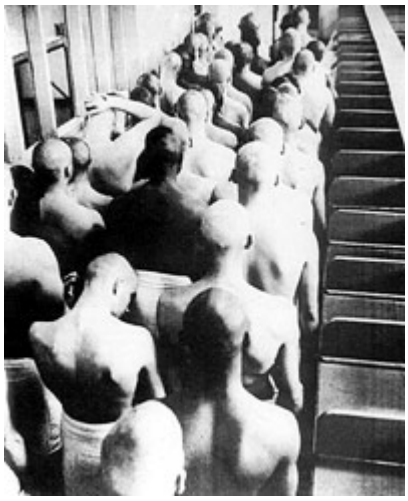


Weidenfeld & Nicolson; 436 pages; £20

Buy it at
Amazon.co.uk

Technology may have altered the face of war, but it has not changed its human nature. In his classic account of the making of a soldier, now updated and with a new introduction, Mr Holmes shows how armies have sought to scrape off every shred of civilian identity from a recruit and build the vital *esprit de corps*—and how green soldiers cope with the fear of being afraid that precedes first combat. Then come the eerie emptiness of battlefields, stress and exhaustion, lice, hunger, the lack of privacy, but also the special camaraderie that develops within a unit. Mr Holmes links the emphasis on masculine virtues with the staggering impact of venereal diseases on troops, which led the French to set up licensed brothels to cut down on casualties. During the first world war, Clemenceau even offered to set up some for American troops, but he was turned down. In French Indochina, two prostitutes were recommended for decoration, after being ambushed on their way back from doing their duty in a distant outpost.

Men cope with fear and horror through denial, hard work, superstition, fatalism, prayer and humour. Drinks and drugs also help relieve stress: in 1970, 11,000 American soldiers were charged with using hard drugs—and the real number of users was believed to be five times as high. Religion also offers solace, and justification. “Whatever we were doing—murder, atrocities—God was always on our side,” remarks a Vietnam veteran.



Making an American marine

What makes men fight? Ideology and religion play a role, particularly in early stages, but personal bonds created within fighting units, as well as the determination to survive, provide a stronger motivation. It is group cohesion that motivates soldiers to march on and sustain self-imposed discipline. Charismatic and self-sacrificing leadership is vital. “Troops are like spaghetti,” remarked George Patton, an American general. “You can't push them around, you have to pull them.” Strong *esprit de corps* can also work against the institution it is supposed to serve, when it finds its expression in mutiny or deliberate inaction.

Training and language are often used to portray the enemy as hateful, barbaric or sub-human, as in Menachem Begin's description of Palestinians as “beasts walking on two legs”. This helps justify killing in the minds of many soldiers. The danger is quite literally overkill, when the awareness of a common humanity—which can paralyse soldiers—is erased by a hatred so intense it leads to atrocities. A GI described the My Lai massacre in Vietnam as being like “scratching an itch...it's going to drive you mad unless you do it.”

Mr Holmes makes a convincing case that the human being remains the central weapon of military conflict, technology notwithstanding. What emerges is a compelling and very human portrait of war.

Acts of War: The Behaviour of Men in Battle.

By Richard Holmes.
Weidenfeld & Nicolson; 436 pages; £20

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About sponsorship

Escape from Sudan

Modern slavery

Feb 19th 2004
From The Economist print edition

How two young people escaped from captivity

SUDAN has been at war longer than anywhere else in a continent plagued by conflict. According to international aid groups, the civil war, in which northern Arabs, who rule the country, are opposed by southern rebels, has claimed, directly or indirectly, the lives of 2m southerners and displaced over 4m.

Besides the horrors common to all wars, however, the conflict in Sudan has made another kind of casualty: thousands of southern women and children abducted and turned into slaves. In October 2002, George Bush signed the Sudan Peace Act, which formally condemns the Sudanese government for using slavery as a weapon of war.

Francis Bok's childhood ended when he was seven. He was uprooted from a happy life on his family farm in southern Sudan when an Arab militia descended on the nearby village, slaughtering men while harvesting children and women as slaves. The young Francis spent the following ten years tending the livestock of his master. He was continually beaten and generally despised, his life reduced to misery, loneliness and constant fear. He was 17 when he escaped.

Mr Bok, now aged 23 and living in the United States, has become an activist on behalf of the millions of people believed to live in slavery around the world, but particularly in Sudan. He has testified before the Senate Foreign Relations Committee and spoke out against Sudan's slavery at the United Nations.

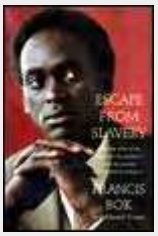
Mende Nazer comes from the Nuba mountains. Her people are Muslims, but they are black, unlike the Muslims from the north. She was a lively and smart child, with dreams of being a doctor. She describes a simple life made of laughter and storytelling around the fire, but also of the customs of excruciating female circumcisions and child brides.

When she first came to Khartoum, the capital, she saw strange trees with fruits made of bright lights lining the streets, and there were so many cars she thought they were reproducing, like cattle. She was 12, and about to be sold as a house slave, after being kidnapped during a raid on her village. She became a frightened and lonely shadow of herself.

In her late teens, she was shipped to her owner's sister and her diplomat husband in London, and continued her life as a slave. Helped by a fellow Sudanese, she escaped. Slowly, Miss Nazer has learnt freedom—as well as English and how to cope with such challenges as negotiating her way through London's buses.

Miss Nazer and Mr Bok are free today, but thousands are still enslaved. To western readers, the slave trade may seem from another age, but their tales of uprooting, brutality and despair remind us that it exists today. Miss Nazer, speaking through Damien Lewis's pen, dwells on her Nuba childhood with a childlike quality, and her story ends with her London escape and struggle to obtain asylum. Mr Bok attempts to put his personal tragedy in a broader political context and provides an account of his life as an anti-slavery activist in the United States. Ultimately, both celebrate their rebellion against injustice and the triumph of the human spirit.

Escape From Slavery: The True Story of My Ten Years in Captivity—and My Journey to Freedom in America
By Francis Bok and Edward Tivnan



St Martin's Press; 284 pages; $24.95

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Slave: My True Story
By Mende Nazer and Damien Lewis

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About sponsorship

Latin up to date

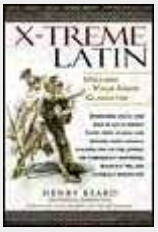
A little help for homunculus

Feb 19th 2004
From The Economist print edition

FOR years now, Henry Beard, the founder of *National Lampoon*, has been pursuing a rollicking crusade to put Latin back in everyday life. As he explains, Latin is widely used by lawyers to cheat you, by doctors to scare you witless and by houseplant sellers to shift their wares. (See, under “Botanical Latin”, *grandiflora*, *tormentosa*, *pendula*, *rugosa* and *sempervirens*, all of which mean “leafless clump of dry brown twigs in one week flat”.) This book lets the *homunculus* (little guy) get his own back.

And how. There are insults here for every occasion, from air rage (*Heia, amice, utrum illae sunt sarcinae tuae, an modo Carthaginem despoliasti?,* “Hey, pal, is that carry-on luggage or did you just sack Carthage?”) to computer trouble (*Assume plicam damnatam, o tu moles muscaria muscerdarum*, “Download the goddam file, you bug-ridden piece of shit”). But there are handy phrases too for bumper stickers (*Malim praedari*, “I'd rather be pillaging”) and invaded barbarians (*Vos non victores, sed liberatores salutamus!*, “We welcome you as liberators, not conquerors!”). All through the book, the morphing of empire-building Romans with Americans, chariots with Cadillacs, swords with guns and Julius Caesar with Jesus Christ (“What would Caesar do?”) is an endlessly diverting read.

X-Treme Latin: Unleash Your Inner Gladiator
By Henry Beard



Gotham Books; 108 pages; $17.50

Buy it at
Amazon.com
Amazon.co.uk

First prize for devilish translating goes to “wet T-shirt contest” (*certamen inter mammosas tunicis madefactis vestitas*), closely followed by “sushi bar” (*taberna Iaponica pulpamentorum incoctorum marinorum*). The finest-resonance award goes to *crapulentus sum* (“I'm wasted!”). But since Latin is for lovers, special mention should go to a highly topical chat-up line containing the much-maligned future perfect: *Nisi mecum concubueris, phobistae vicerint,* “If you won't sleep with me, the terrorists will have won.”

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Christianity on film

The problem of realism

Feb 19th 2004
From The Economist print edition

Depicting the real Jesus

NEXT Wednesday sees the official American launch of “The Passion of the Christ”, a film about Jesus directed by Mel Gibson, a Roman Catholic. Advance reports suggest that it will be controversial. Critics have questioned whether there is a limit to the realism the public will bear.

Reuters

Too much for the filmgoer?

All the best films about Christ have been controversial and all the weakest ones, however well intentioned, anodyne. They got off to a feeble start with “From the Manger to the Cross”, made by Sidney Olcott in 1912 and shot in the Holy Land. In its day, its biblical tableaux, reminiscent of Sunday school illustrations, were regarded as exemplary. In reality, it was a false trail that misled Hollywood for the better part of a century.

Jesus was a tough egg, preaching lessons as radical and unpalatable to the Jewish establishment as to its Roman masters. This never registers in the films Hollywood made about him over the next generation. Take the two versions of “King of Kings”: Cecil B. DeMille's silent film of 1927 and Nicholas Ray's 1961 remake. DeMille follows the Olcott line of biblical storybook illustrations, with the Resurrection depicted in the then two-colour Technicolor system. Ray's remake panders to teenage tastes by choosing heart-throb Jeffrey Hunter for the title role, then compounds it by having Salome perform a raunchy dance of the seven veils.

George Stevens's “The Greatest Story Ever Told” (1965) is little better. Picking Max von Sydow (Ingmar Bergman's lead actor) to play Christ was a smart move, but surrounding him with Hollywood hacks was not. No film could live down the casting of John Wayne as a Roman centurion proclaiming that “Truly this man was the Son of Gahd”.

In search of a new angle, Hollywood even turned the life of Christ into a musical. Norman Jewison's “Jesus Christ Superstar” (1973) was a film version of the Andrew Lloyd Webber show that turned a coy eye on Mary Magdalene's ill-defined relationship with Jesus and celebrated him as a future begetter of platinum discs.

These films, from Olcott to Jewison, view Jesus as the pin-up of his day. But where was the man who overthrew the money-changers in the temple? And paid a terrible price for it? Hollywood kept quiet on that one. So did television. Two mini-series have tackled the Crucifixion: Franco Zeffirelli's 1978 “Jesus of Nazareth” with Robert Powell, and “Jesus” (2000), a $20m extravaganza from Time-Life starring Jeremy Sisto from “Clueless” as Jesus and Jacqueline Bisset as Mary. Missing from all these films is any hint why Jesus in his day was regarded as dangerous. For that perspective turn to Italy. Pier Paolo Pasolini's “The Gospel According to St Matthew” (1964), with its emphasis on Marxist social equality before God, is unlike any other biblical movie. It is shot as if a roving camera had been present in the Holy Land at the time; it catches lived-in faces, including the director's mother as Mary, and it looks as if the images, free of any trace of the picturesque, had assembled themselves into unforgettable shots. It presents Jesus as the threat he undoubtedly was to the authorities, religious and secular, of his time.

Look, however, to Hollywood for the most convincing portrait of Jesus the man. Martin Scorsese's “The Last Temptation of Christ” (1988) is the only film to show that he was wholly man as well as God. As a man should he not live life to the full? Those who branded the film a sex melodrama simply missed the point. The few good films about Christ have indeed been controversial.

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The Oscars

Just a bit quirky

Feb 19th 2004
From The Economist print edition

Predicting the unpredictable

AP

Critics' choice: Scarlett Johansson and Bill Murray in “Lost in Translation”

THIS year's Oscars, to be awarded on February 29th, may (but probably won't) be different from the norm. The Academy of Motion Picture Arts and Sciences, which bestows the awards, would like to think so. But let's see.

Several things have, indeed, changed. The ceremony is a month earlier this time so that it is not seen as a tail-ender in the congratulations stakes. But it still trails the Golden Globes, widely seen as a pointer to the Oscars. There was a backlash, too, from independent producers against a ban, later lifted, on free DVDs to eligible voters. Ostensibly introduced to discourage piracy, the ban was seen as a covert advantage for big-studio blockbusters. There is anecdotal evidence, however, that Academy members have actually been more conscientious than usual, seeking out the little films they might otherwise have missed.

Then there is the question of age. The Academy, which is made up of Hollywood veterans and includes all previous nominees, was reckoned to be an ageing body. Oldsters, it was claimed, are predisposed to honour films most like the ones they themselves made when young. Not so, claims the Academy. Younger nominees are joining every year.

This year's nominees are certainly quirkier, less predictable than for some years past. Only two of the five nominees for best film are box-office winners: the final part of “The Lord of the Rings” trilogy and “Master and Commander: The Far Side of the World”. Ranged against them are “Lost in Translation”, “Mystic River” and (a real surprise) “Seabiscuit”, about a horse whose prowess mirrors America's recovery from the Depression.

The Tolkien adaptation (box-office tally $345m and climbing) would normally be Hollywood's way of patting itself on the back, but in a year when the Academy itself is being questioned, members just might opt for quality. “Lost in Translation” is the funniest and most touching film of the year. It did not take a fortune at the box-office ($37m to date), but that is not a bad return for a film that cost $4m. “Lost in Translation” is directed by Francis Ford Coppola's daughter Sofia. Some, however, may judge her rise too fast and too recent to be sure. The best director award will probably go to New Zealand's Peter Jackson, for “Rings”. Peter Weir (for “Master and Commander”), Clint Eastwood, for “Mystic River”, and outsider Fernando Meirelles (for “City of God”) are also in with a chance.

Best actor? Bill Murray, who has won a Golden Globe and a sheaf of awards from critics for his work in “Lost in Translation”, looks unbeatable. Johnny Depp for “Pirates of the Caribbean” and Jude Law for “Cold Mountain” are lightweight in comparison, while Sean Penn for “Mystic River” must surely await another day. Ben Kingsley in “House of Sand and Fog” is a serious contender, but has already won for “Gandhi” in 1982. No British citizen has yet taken this award twice, though Peter Ustinov and Michael Caine both snagged a couple of supporting trophies.

Of the actresses, teenaged Keisha Castle-Hughes (for “Whale Rider”), Samantha Morton (for the little seen “In America”) and Naomi Watts (for “21 Grams”) look like also-rans. Diane Keaton is nominated for “Something's Gotta Give”, but she won in 1977 for “Annie Hall”. The favourite must be Charlize Theron in “Monster” as multiple murderess Aileen Wuornos. It is not a sympathetic part, which sometimes goes against the feel-good grain on Oscar night, but many may decide she delivers the goods, as Hilary Swank did in her winning turn in “Boys Don't Cry” (1999).

In supporting categories one actor looks a dead cert: Tim Robbins in “Mystic River”. His rivals, Djimon Hounsou, for “In America”, Japan's Ken Watanabe for “The Last Samurai”, Alec Baldwin for “The Cooler” and a past-winner, Benicio Del Toro, for “21 Grams” face an uphill struggle.

Best supporting actress is harder to call. Marcia Gay Harden (a surprise winner for “Pollock” in 2000) is nominated again for “Mystic River”, along with Holly Hunter in “Thirteen” (a winner in 1993 for her work in “The Piano”) and Shohreh Aghdashloo for “House of Sand and Fog”. Choose instead between Renée Zellweger for her over-the-top performance in “Cold Mountain” and Patricia Clarkson for “Pieces of April”. Miss Zellweger is the front-runner, not least because she was pipped at the post last year for “Chicago” and sentimental Hollywood loves nothing better than to make amends.

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Eddie Clontz

Feb 19th 2004
From The Economist print edition

American Media

Eddie Clontz, master of tabloid journalism, died on January 26th, aged 56

THE relationship between truth and reporting has ever been a tricky one. No scene remains undistorted as it passes the eye of the beholder, and none reaches the page exactly as it was. But while living with this discrepancy, many journalists struggle with a much baser temptation. What they really want to put into their copy is that extraordinary “fact”, that jaw-dropping story retailed by a single source down a crackling telephone line, which would earn them a banner headline if they could only stand it up.

Eddie Clontz felt this more than most, and he never resisted the temptation. As the deviser and, for 20 years, the editor-in-chief of *Weekly World News*, his delight was to run the wildest stories he could find. He described himself not as an editor but as a circus-master, drawing readers into his tent with an endless parade of fantasies and freaks.

The *News* had, and has, an unassuming look, a black-and-white tabloid with blurry graphics that sits at supermarket checkouts across America, among the chewing gum. But its headlines, in inch-high sans serif, are another matter. “ARCHEOLOGISTS FIND MIDDLE EARTH IN NEW JERSEY SWAMP!”“SEVEN CONGRESSMEN ARE ZOMBIES!”“TINY TERRORISTS DISGUISED AS GARDEN GNOMES!” (“‘These guys are typical al-Qaeda operatives,' says a top CIA source, ‘with beards down to their belt buckles'.”) Such stories, all from one recent issue, would have made Mr Clontz proud.

The *News* for which he was hired, in 1981, was a sorry affair, a dumping ground for stories that failed to make the *National Enquirer.* It had been started mostly to make use of the *Enquirer*'s old black-and-white presses after the sister-tabloid had gone to colour. Mr Clontz soon shook it up. Out went the tired celebrity gossip; in came space aliens, dinosaurs, giant vegetables, and a “Psychic” column in which his brother Derek would find readers' car keys. Circulation soared. In a good week, it can reach well over a million.

Two stories in particular got Mr Clontz noticed. In 1988, his organ revealed that “ELVIS IS ALIVE! (King of Rock 'n' Roll Faked his Death and is Living in Kalamazoo, Mich!)”. A few years later, the *News* reported that a bat boy, with huge ears and amber eyes and “eating his own weight in insects each single day”, had been found by scientists in a cave in West Virginia.

Both items were followed up for years. Elvis went on appearing; Bat Boy escaped, was recaptured by the FBI, fell in love and endorsed Al Gore for president. Readers wrote in with their own sightings, bolstering

whatever truth the nation believed was there. In 1993, Mr Clontz dared to kill the resurrected Elvis ("ELVIS DEAD AT 58!")—only to reveal some time later that this death, too, had been a hoax.

Scallops to scoops

Sheer chance seemed to bring Mr Clontz to this strange outpost of journalism. After dropping out of school at 16 and trying his luck as a scallop fisherman, he became a copy boy on his local paper in North Carolina. He moved next to a Florida paper, and from there to the disreputable corner office in the *Enquirer* building, in a run-down resort near Palm Beach, from which he was to entertain and terrify America.

His own politics were mysterious. Under the pseudonym "Ed Anger", he wrote a *News* column so vitriolically right-wing that it possibly came from the left. Anger hated foreigners, yoga, whales, speed limits and pineapple on pizza; he liked flogging, electrocutions and beer. No, Mr Clontz would say, he had no idea who Anger really was. But he was "about as close to him as any human being."

Mr Clontz also always denied that his staff made the stories up. It was subtler than that. Many tips came from "freelance correspondents" who called in; their stories were "checked", but never past the point where they might disintegrate. ("We don't know whether stories are true," said Mr Clontz, "and we really don't care.") The staff also read dozens of respectable newspapers and magazines, antennae alert for the daft and the bizarre. When a nugget was found, Mr Clontz would order them to run away with it, urging them to greater imaginative heights by squirting them with a giant water-pistol.

Yet he also showed care for authenticity. If a story resisted tracking down, he would give it the dateline "Bolivia". If it relied on "scientific research", he would make sure the scientists were Bulgarian. Writers who made up the names of Georgia natives terrorised by giant chickens would be asked to check in the telephone book to make sure they did not exist. Loving editorial attention was given to the face of Satan when he appeared in a cloud formation over New York.

The result of this was that many readers appeared to believe Mr Clontz's stories. Letters poured in, especially from the conservative and rural parts of the country where Ed Anger's columns struck a chord. If a sensible man like Anger kept company with aliens and 20-pound cucumbers, perhaps those stories too were true. When the *News* reported the discovery of a hive of baby ghosts, more than a thousand readers wrote in to adopt one. But the saddest tale was of the soldier who wrote, in all seriousness, offering marriage to the two-headed woman.

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Overview

Feb 19th 2004
From The Economist print edition

In the year to January, **America's industrial production** rose by 2.4%, the fastest 12-month figure since 2000. In the month of January itself, industrial production rose a healthy 0.8%, up from no growth in December. Manufacturing output, however, is growing with far less vigour: it rose in January by only 0.3%, which was less than expected. Worse still, December's manufacturing-output growth was revised down to 0.1%.

Despite a weakened dollar, America's imports reached an all-time high and exports fell slightly in December. The **goods and services trade deficit** ballooned by almost 11% to $43 billion during the month. During 2003 as a whole, the trade deficit widened to $489 billion, a 17% rise over the previous year and another all-time high.

The **euro** continued its rise against the dollar, and hit an all-time high of $1.29. The dollar also fell against **sterling**, which hit $1.91, its highest level since 1992.

The **euro area's GDP** grew by 0.3% in the fourth quarter, and by 0.6% in the year to the fourth quarter. Industrial production in the euro area rose by 2.3% in the year to December. **Germany's** ZEW economic sentiment index fell to 69.9 in February from 72.9 in January thanks partly to worries about a stronger euro and the slow pace of economic reforms. In **Spain**, consumer prices rose in the year to January by 2.3%, the slowest increase in more than four years. Industrial production in **Italy** fell by 0.2% in the year to December.

Britain's consumer prices, as measured by the CPI, fell by 0.5% in January. The CPI rose by 1.4% in the year to January, up from 1.3% in the year to December.

Wages in Denmark rose by 3.7% in the year to the fourth quarter. In **Sweden**, industrial production declined by 3.6% in the year to December.

Japan's economy is rebounding. GDP grew at an annual rate of 7.0% in the fourth quarter, the fastest rate in over 13 years. Strong growth in exports, especially to China, and rising investment spending helped the economy to grow by much faster than analysts had forecast. However, in nominal terms—taking into account Japan's price deflation— the economy grew by a more modest 2.6% at an annual rate. Industrial production rose by 5.9% in the year to December.

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Output, demand and jobs

Feb 19th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.6	Q3	+ 4.8	+ 2.8	+ 3.7	– 0.1	Q3	+ 7.3	Q4	5.7	Jan	6.1
Austria	+ 0.8	Q3	+ 1.4	+ 0.9	+ 1.9	+ 7.2	Aug	– 6.1	Nov	4.6	Dec	4.3
Belgium	+ 0.8	Q3	+ 2.2	+ 1.0	+ 1.9	– 6.6	Nov	– 4.3	Nov	12.9	Jan†	11.9
Britain	+ 2.5	Q4	+ 3.8	+ 2.1	+ 2.8	– 0.8	Dec	+ 6.4	Jan	4.9	Dec††	5.1
Canada	+ 1.0	Q3	+ 1.1	+ 1.7	+ 3.1	nil	Nov	+ 2.1	Nov	7.4	Jan	7.5
Denmark	– 0.5	Q3	– 0.8	+ 0.3	+ 2.2	– 0.2	Dec	+ 2.3	Dec	6.6	Dec	5.4
France	+ 0.5	Q4	+ 2.0	+ 0.2	+ 1.9	+ 2.0	Dec	– 2.2	May	9.7	Dec	9.3
Germany	+ 0.2	Q4	+ 0.9	– 0.1	+ 1.7	+ 3.5	Dec	– 2.5	Nov	10.2	Jan§	10.3
Italy	+ 0.1	Q4	nil	+ 0.5	+ 1.7	– 0.2	Dec	– 2.8	Nov	8.4	Oct	8.9
Japan	+ 3.6	Q4	+ 7.0	+ 2.3	+ 2.1	+ 5.9	Dec	+ 0.4	Dec	4.9	Dec	5.3
Netherlands	– 0.5	Q4	+ 1.2	– 0.8	+ 1.0	– 3.0	Dec	– 5.5	Nov‡	5.9	Jan**	4.4
Spain	+ 2.4	Q3	+ 2.9	+ 2.4	+ 3.0	+ 3.6	Dec	+ 2.9	Nov	11.2	Dec	11.5
Sweden	+ 2.0	Q3	+ 1.9	+ 1.6	+ 2.4	– 3.6	Dec	+ 4.2	Dec	5.9	Jan†	5.1
Switzerland	– 0.6	Q3	+ 1.0	– 0.4	+ 1.6	+ 0.4	Q3	+ 1.3	Dec	4.3	Jan†	3.5
United States	+ 4.3	Q4	+ 4.0	+ 3.2	+ 4.6	+ 2.4	Jan	+ 7.4	Dec	5.6	Jan	5.8
Euro area	+ 0.6	Q4	+ 1.2	+ 0.5	+ 1.9	+ 2.3	Dec	– 1.6	Nov	8.8	Dec	8.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.6	Q3	+ 3.2	na	na	+ 1.0	Dec	+ 2.5	Dec	8.2	Dec†	8.1
Greece	+ 5.0	Q3	+ 1.8	na	na	+ 3.9	Oct	+ 5.2	Sep	na		na
Iceland	+ 3.2	Q3	na	na	na	– 0.3	2002	na		3.4	Dec†	3.0
Ireland	– 0.1	Q3	na	na	na	+17.0	Dec	+ 1.2	Nov	4.7	Jan	4.3
Luxembourg	+ 1.3	2002	na	na	na	+ 4.4	Nov	+ 2.0	Sep	4.1	Dec	3.4
New Zealand	+ 3.5	Q3	+ 6.3	na	na	+ 4.1	Q3	+ 6.0	Q4	4.6	Q4	4.9
Norway	+ 0.2	Q3	+ 3.3	na	na	– 4.5	Dec	+ 4.4	Dec	4.2	Q4	3.7
Portugal	– 0.9	Q3	– 2.1	na	na	+ 2.0	Dec	– 0.4	Nov	6.6	Q4†	6.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Oct-Dec; claimant count rate 2.9% in Jan. §EU harmonised rate 9.2% in Jan. **Nov-Jan.

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Prices and wages

Feb 19th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 2.4	Q4	+ 3.0	+ 2.7	+ 2.2	– 1.1	Q4	+ 1.6	+ 5.1	Q3	+ 3.6
Austria	+ 1.2	Dec	+ 1.8	+ 1.3	+ 1.2	+ 2.2	Jan	+ 1.4	+ 2.3	Dec	+ 2.2
Belgium	+ 1.6	Jan	+ 1.2	+ 1.5	+ 1.4	– 0.4	Dec	+ 1.9	+ 1.8	Q4	+ 2.2
Britain	+ 1.4	Jan*	+ 1.4	+ 1.4	+ 1.5	+ 1.6	Jan	+ 1.3	+ 3.4	Dec	+ 3.7
Canada	+ 2.0	Dec	+ 3.9	+ 2.7	+ 1.6	– 3.4	Dec	+ 2.8	+ 3.5	Nov	+ 1.9
Denmark	+ 1.1	Jan	+ 2.6	+ 2.1	+ 1.6	+ 0.3	Jan	+ 1.3	+ 3.7	Q4	+ 3.9
France	+ 2.2	Dec	+ 2.3	+ 2.1	+ 1.7	+ 0.4	Dec	+ 1.3	+ 2.9	Q3	+ 3.5
Germany	+ 1.2	Jan	+ 1.1	+ 1.1	+ 1.0	+ 0.4	Jan	+ 1.2	+ 1.6	Dec	+ 3.1
Italy	+ 2.2	Jan	+ 2.8	+ 2.8	+ 2.3	+ 0.8	Dec	+ 2.0	+ 2.7	Dec	+ 2.2
Japan	– 0.4	Dec	– 0.3	– 0.3	– 0.2	nil	Jan	– 1.0	+ 1.9	Dec	– 1.4
Netherlands	+ 1.4	Jan	+ 2.4	+ 2.2	+ 1.5	+ 0.6	Dec	+ 4.2	+ 1.8	Jan	+ 3.5
Spain	+ 2.3	Jan	+ 3.7	+ 2.9	+ 2.6	+ 1.1	Dec	+ 2.0	+ 3.1	Q3	+ 3.8
Sweden	+ 1.4	Dec	+ 2.3	+ 2.1	+ 1.4	– 1.9	Dec	– 0.6	+ 3.3	Nov	+ 3.9
Switzerland	+ 0.2	Jan	+ 0.9	+ 0.6	+ 0.5	– 0.2	Jan	– 0.2	+ 1.8	2002	+ 2.5
United States	+ 1.9	Dec	+ 2.4	+ 2.3	+ 1.5	+ 4.0	Dec	+ 1.2	+ 2.0	Jan	+ 3.0
Euro area	+ 2.0	Jan	+ 2.1	+ 2.0	+ 1.7	+ 1.0	Dec	+ 1.5	+ 2.6	Q3	+ 3.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.2	Jan	+ 1.4	na	na	– 0.7	Jan	+ 1.4	+ 3.9	Q3	+ 4.1
Greece	+ 2.9	Jan	+ 3.1	na	na	+ 2.0	Dec	+ 1.5	na		na
Iceland	+ 2.3	Feb	+ 1.5	na	na	+ 1.3	Jan	+ 2.7	+ 5.4	Dec	+ 5.4
Ireland	+ 1.8	Jan	+ 4.8	na	na	– 9.1	Dec	– 2.5	+ 4.7	Q3	+ 6.0
Luxembourg	+ 2.1	Dec	+ 2.2	na	na	+ 0.8	Nov	– 0.1	+ 0.6	Nov	+ 3.2
New Zealand	+ 1.6	Q4	+ 2.7	na	na	+ 0.1	Q3	– 2.1	+ 2.3	Q4	+ 2.1
Norway	– 1.8	Jan	+ 5.0	na	na	– 0.1	Jan	+11.6	+ 4.3	Q3	+ 5.0
Portugal	+ 2.3	Jan	+ 4.0	na	na	nil	Dec	+ 1.3	– 1.7	Nov	– 0.5

*New series. RPI inflation rate in January: 2.6%.

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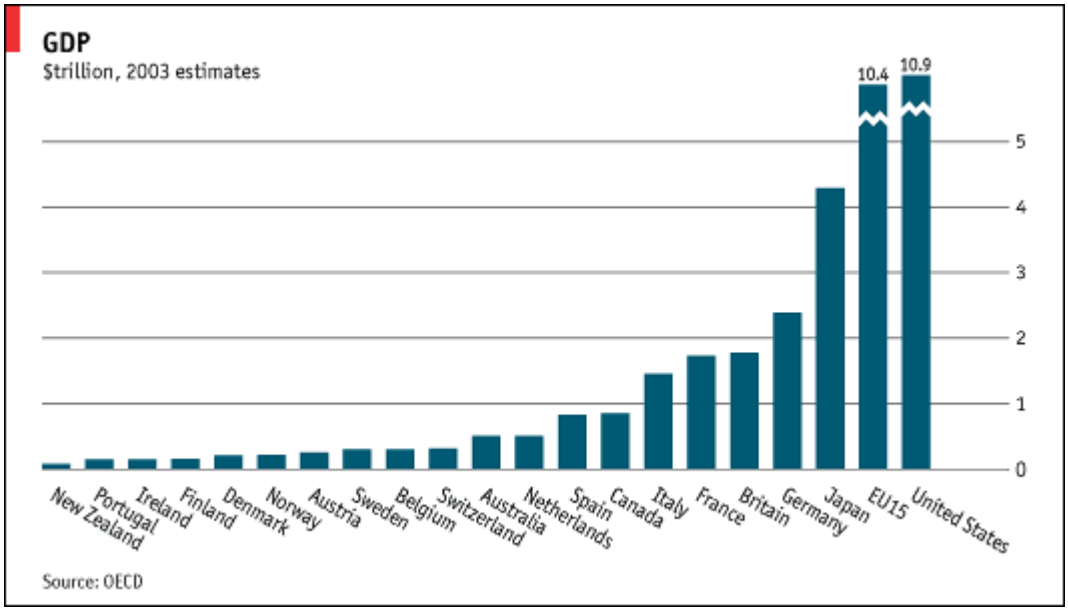
GDP

Feb 19th 2004
From The Economist print edition



The chart shows how rich economies ranked by their size of GDP in 2003 (at market exchange rates). According to estimates by the OECD, the total GDP of the 15 members of the European Union was $10.4 trillion, not far behind America's $10.9 trillion. If the dollar remains weak, the EU will overtake America this year. Despite the fall in sterling against the euro last year, Britain's GDP remained larger than France's.

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Money and interest rates

Feb 19th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Feb 18th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 8.7	+13.7	Dec	5.55	4.69	5.30	5.55	5.22	6.42
Britain	+ 7.7	+ 8.4	Jan	4.09	3.63	4.19	4.79	4.15	5.55
Canada	+10.0	+ 6.9	Dec	2.19	2.78	2.45	4.45	5.06	5.85
Denmark	+ 8.8	+ 8.8	Dec	2.18	3.11	2.43	4.19	4.13	5.26
Japan	+ 4.3	+ 1.6	Jan	0.03	0.03	0.05	1.23	0.87	1.39
Sweden	+ 2.8	+ 2.6	Dec	2.42	3.60	2.97	4.40	4.39	3.07
Switzerland	+25.2	+ 9.0	Jan	0.26	0.60	0.36	2.38	2.23	2.31
United States	+ 5.6	+ 4.3	Jan	1.01	1.38	1.68	4.03	3.86	5.64
Euro area†	+10.6	+ 7.1	Dec	2.06	2.69	2.27	4.03	3.89	3.84

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.90%, Japan No. 257 1.23%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.0%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Feb 19th 2004
From The Economist print edition

1995=100

	Feb 10th	Feb 17th*	% change on one month	% change on one year
Dollar index				
All items	93.2	95.0	+ 2.4	+20.5
Food	89.4	90.3	– 0.6	+11.0
Industrials				
All	98.5	101.5	+ 6.2	+34.5
Nfa†	95.1	95.9	+ 1.5	+21.1
Metals	101.4	106.2	+10.1	+46.9
Sterling index				
All items	78.9	78.8	– 2.2	+ 0.9
Euro index				
All items	96.6	97.5	+ 0.3	+ 0.5
Yen index				
All items	104.8	107.1	+ 1.0	+ 7.1
Gold				
$ per oz	408.50	413.50	+ 0.5	+19.9
West Texas Intermediate				
$ per barrel	33.92	35.17	– 2.3	– 4.5

* Provisional. † Non-food agriculturals.

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Stockmarkets

Feb 19th 2004
From The Economist print edition

Market indices

	Feb 18th	2003-04 high	2003-04 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,365.2	3,365.2	2,673.3	+ 1.5	– 2.2	+13.1	+59.6
Austria (ATX)	1,788.3	1,803.4	1,120.2	+ 0.6	– 0.8	+55.5	+90.0
Belgium (Bel 20)	2,476.9	2,476.9	1,426.6	+ 2.4	–32.7	+22.3	+49.5
Britain (FTSE 100)	4,442.9	4,518.1	3,287.0	+ 1.1	–35.9	+12.8	+33.4
Canada (Toronto Composite)	8,717.8	8,767.7	6,228.6	– 0.6	–23.5	+31.8	+58.6
Denmark (KBX)	234.8	237.6	145.0	– 0.6	–22.2	+41.2	+72.1
France (SBF 250)	2,538.9	2,538.9	1,630.1	+ 1.1	–42.2	+23.7	+51.1
(CAC 40)	3,709.0	3,709.0	2,403.0	+ 0.8	–46.4	+21.1	+48.0
Germany (DAX)	4,095.3	4,151.8	2,203.0	– 0.7	–49.2	+41.6	+73.0
Italy (BCI)	1,297.4	1,310.9	959.4	nil	–40.6	+18.8	+45.2
Japan (Nikkei 225)	10,676.8	11,161.7	7,607.9	+ 3.0	–72.6	+24.5	+39.0
(Topix)	1,053.0	1,105.6	770.6	+ 2.7	–63.5	+24.9	+39.5
Netherlands (AEX)	361.3	361.3	218.4	+ 1.0	–48.5	+12.0	+36.8
Spain (Madrid SE)	864.1	864.1	576.8	+ 0.9	–24.6	+36.3	+66.6
Sweden (Affarsvarlden Gen)	207.0	207.0	127.8	+ 0.6	–48.3	+42.6	+73.5
Switzerland (Swiss Market)	5,828.8	5,882.1	3,675.4	– 0.9	–30.7	+25.9	+41.6
United States (DJIA)	10,672.0	10,737.7	7,524.1	– 0.6	– 9.0	+27.9	+27.9
(S&P 500)	1,151.8	1,157.8	800.7	– 0.5	–24.6	+30.9	+30.9
(NASDAQ Comp)	2,076.5	2,153.8	1,271.5	– 0.6	–58.9	+55.5	+55.5
Europe (FTSE Eurotop 300)*	1,003.9	1,005.1	682.7	+ 0.8	–41.1	+17.1	+43.2
Euro area (FTSE Ebloc 100)*	873.5	873.5	565.7	+ 0.4	–43.7	+21.6	+48.6
World (MSCI)†	1,082.3	1,085.8	710.8	+ 0.6	–25.3	+36.6	+36.6
World bond market (Citigroup)‡	619.1	619.5	518.6	+ 0.6	– 0.1	+17.8	+17.8

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Feb 19th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2003	2004	Exchange rate trade-weighted† 1990=100 Feb 18th	year ago	Currency units per $ Feb 18th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2003‡
Australia	− 15.3	Dec	− 27.2	Q3	− 6.2	− 5.3	91.0	76.2	1.26	1.68	2.40	1.61	1.18	0.8
Austria	− 1.2	Nov	− 0.1	Nov	− 0.1	− 0.2	103.2§	101.3	0.78	0.93	1.49	–	0.73	-1.3
Belgium	+ 19.8	Dec	+ 9.9	Sep	+ 4.6	+ 4.8	103.5§	100.7	0.78	0.93	1.49	–	0.73	0.2
Britain	− 74.7	Dec	− 36.1	Q3	− 2.1	− 2.1	105.7	101.8	0.52	0.63	–	0.67	0.49	-2.9
Canada	+ 42.8	Dec	+ 16.7	Q3	+ 1.9	+ 1.3	87.2	77.7	1.31	1.51	2.50	1.68	1.24	1.0
Denmark	+ 9.9	Dec	+ 6.0	Dec	+ 2.7	+ 2.5	107.1	104.7	5.81	6.92	11.1	7.45	5.47	0.8
France	+ 4.9	Dec	+ 18.2	Dec	+ 1.3	+ 1.2	107.1§	103.8	0.78	0.93	1.49	–	0.73	-4.0
Germany	+146.8	Dec	+ 56.3	Dec	+ 2.4	+ 2.6	104.8§	100.9	0.78	0.93	1.49	–	0.73	-4.1
Italy	+ 2.9	Nov	− 19.3	Nov	− 1.1	− 0.9	76.4§	74.0	0.78	0.93	1.49	–	0.73	-2.7
Japan	+105.5	Dec	+136.0	Dec	+ 3.0	+ 3.0	135.6	131.6	105	119	202	136	–	-7.4
Netherlands	+ 31.7	Dec	+ 14.4	Q4	+ 2.8	+ 3.2	103.1§	99.9	0.78	0.93	1.49	–	0.73	-2.4
Spain	− 52.5	Nov	− 26.7	Nov	− 2.5	− 2.5	77.5§	75.5	0.78	0.93	1.49	–	0.73	0.1
Sweden	+ 18.7	Dec	+ 14.8	Q3	+ 5.1	+ 4.9	81.7	79.5	7.16	8.48	13.6	9.18	6.74	0.2
Switzerland	+ 5.7	Dec	+ 29.4	Q3	+10.8	+10.8	110.7	116.1	1.23	1.37	2.34	1.58	1.16	na
United States	−549.4	Dec	−541.7	Q3	− 5.0	− 5.2	93.6	108.5	–	–	1.91	1.28	0.94	-4.9
Euro area	+ 84.2	Nov	+ 38.1	Nov	+ 0.5	+ 0.6	92.4	86.3	0.78	0.93	1.49	–	0.73	-2.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.5	Dec	+ 9.2	Dec	na	na	82.3§	79.6	0.78	0.93	1.49	–	0.73	2.6
Greece	− 25.7	Dec	− 11.3	Dec	na	na	59.8§	58.3	0.78	0.93	1.49	–	0.73	-1.6
Iceland	− 0.2	Nov	− 0.4	Q3	na	na	93.4**	92.1	68.1	79.0	130	87.3	64.1	-1.0
Ireland	+ 38.5	Nov	− 2.1	Q3	na	na	95.6§	90.3	0.78	0.93	1.49	–	0.73	-1.0
Luxembourg	− 3.4	Nov	+ 2.0	Q3	na	na	103.5§	100.7	0.78	0.93	1.49	–	0.73	-0.3
New Zealand	− 2.1	Dec	− 3.3	Q3	na	na	108.0	97.1	1.42	1.81	2.71	1.82	1.34	2.6
Norway	+ 28.1	Jan	+ 28.7	Nov	na	na	91.8	105.2	6.88	7.01	13.1	8.82	6.47	9.8
Portugal	− 13.5	Nov	− 8.2	Nov	na	na	93.4**	91.1	0.78	0.93	1.49	–	0.73	-2.9

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, December average. ‡OECD estimate.
**IMF, October average.

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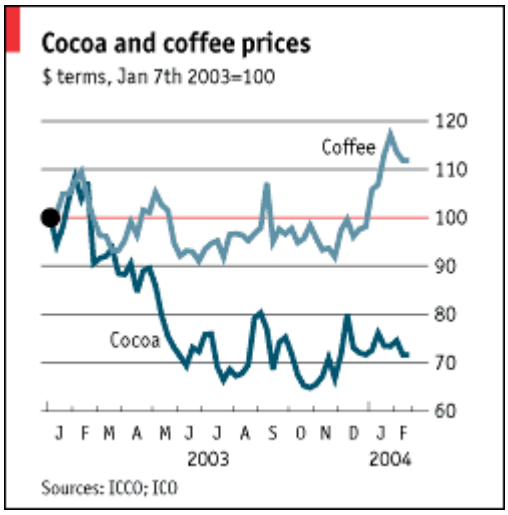
Cocoa and coffee prices

Feb 19th 2004
From The Economist print edition

Despite unrest in Côte d'Ivoire, cocoa prices retreated from 17-year highs in 2003 thanks to a world record crop. Coffee prices, by contrast, are rising and poised for further growth in 2004. Coffee production is expected to fall below demand for the first time in six years.



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Overview

Feb 19th 2004
From The Economist print edition

After rising sharply in recent months, **China's** 12-month rate of consumer-price inflation held steady at 3.2% in January. Worries about the economy overheating were also eased by slower money-supply growth.

Brazil's inflation rate fell from 9.3% in December to 7.7% in January, its lowest since August 2002. In **Israel** consumer prices fell by 2.3% in the year to January.

Mexico's GDP rose by 2.0% in the year to the fourth quarter, as it started to benefit from strong growth in the United States.

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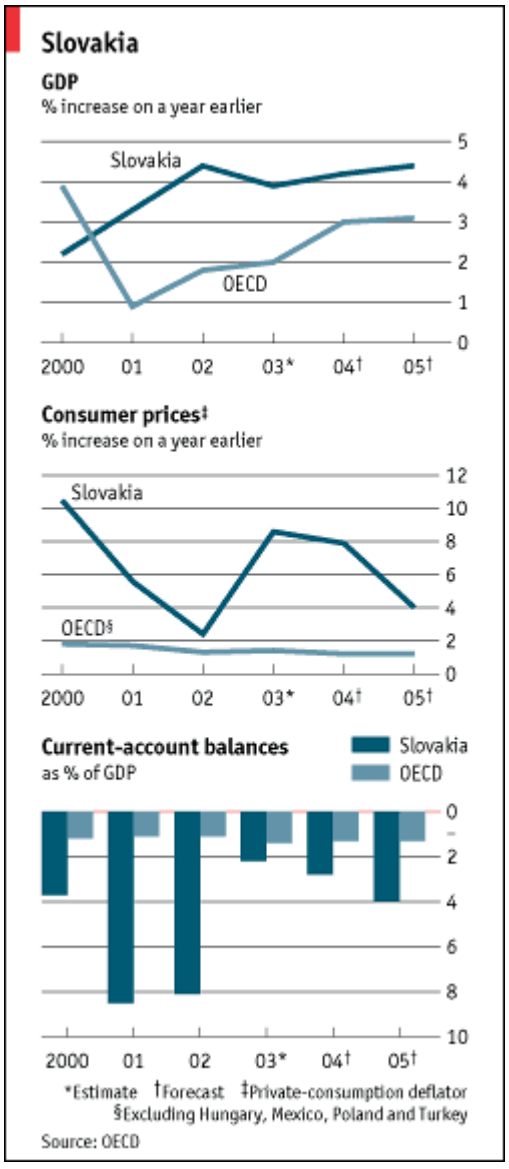
Slovakia

Feb 19th 2004
From The Economist print edition

Slovakia's economy is in good shape, especially when compared with its central European neighbours. Thanks to reforms begun in 2002, including the introduction of a flat tax of 19% on corporate and personal income, the country is poised for continued growth. Foreign direct investment, especially in car manufacturing, looks set to rise. However, the OECD reckons that Slovakia could do more to increase its low employment rate by trimming payroll taxes and cutting social benefits.



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Economy

Feb 19th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q4	+ 7.2	Jan	+ 3.2	Jan	+26.6	Jan	+35.4	2002	403.3	Dec
Hong Kong	+ 4.0	Q3	– 9.2	Q3	– 1.9	Dec	– 8.6	Dec	+17.0	Q3	123.6	Jan
India	+ 8.4	Q3	+ 6.2	Dec	+ 3.7	Dec	–14.8	Dec	+ 2.3	Q3	100.8	Jan
Indonesia	+ 4.3	Q4	+ 4.7	Jul	+ 4.8	Jan	+28.5	Dec	+ 8.1	Q2	35.0	Dec
Malaysia	+ 3.5	Q3	+13.3	Dec	+ 1.0	Jan	+19.6	Dec	+11.9	Q3	43.9	Dec
Philippines	+ 4.5	Q4	– 8.0	Nov	+ 3.4	Jan	– 1.8	Dec	+ 3.1	Oct	12.9	Jan
Singapore	+ 3.7	Q4	+ 0.3	Dec	+ 0.7	Dec	+15.1	Jan	+25.6	Q3	98.6	Jan
South Korea	+ 2.3	Q3	+10.4	Dec	+ 3.4	Jan	+18.8	Jan	+ 9.4	Nov	156.7	Jan
Taiwan	+ 4.2	Q3	+12.4	Dec	nil	Jan	+17.7	Jan	+28.8	Q3	214.9	Jan
Thailand	+ 6.5	Q3	+15.7	Dec	+ 1.2	Jan	+ 4.2	Dec	+ 8.0	Dec	41.1	Dec
Argentina	+ 9.8	Q3	+13.0	Nov	+ 2.7	Jan	+15.5	Dec	+ 8.9	Q3	14.7	Jan
Brazil	– 1.5	Q3	+ 2.9	Dec	+ 7.7	Jan	+25.3	Jan	+ 4.1	Dec	49.3	Dec
Chile	+ 3.0	Q3	+ 1.2	Dec	+ 0.8	Jan	+ 3.1	Jan	– 0.3	Q3	16.0	Jan
Colombia	+ 4.0	Q3	+ 4.9	Nov	+ 6.2	Jan	nil	Nov	– 1.6	Q3	11.1	Jan
Mexico	+ 2.0	Q4	+ 2.4	Dec	+ 4.2	Jan	– 5.6	Dec	–10.5	Q3	59.0	Dec
Peru	+ 3.1	Dec	+ 0.8	Nov	+ 2.8	Jan	+ 0.7	Dec	– 1.2	Q3	9.8	Jan
Venezuela	– 7.1	Q3	– 4.8	Oct	+26.6	Jan	+14.0	Q3	+ 8.9	Q3	16.0	Dec
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.1	Nov	– 6.0	Jul	+ 3.3	Q3	13.9	Nov
Israel	– 0.6	Q4	+ 3.0	Nov	– 2.3	Jan	– 6.1	Jan	– 0.2	Q3	25.9	Jan
South Africa	+ 1.6	Q3	– 1.4	Dec	+ 0.3	Dec	+ 2.1	Dec	– 1.3	Q3	6.5	Dec
Turkey	+ 4.8	Q3	+21.1	Dec	+16.2	Jan	–20.4	Nov	– 5.5	Nov	33.6	Dec
Czech Republic	+ 3.4	Q3	+ 8.9	Dec	+ 2.3	Jan	– 2.6	Dec	– 7.8	Q3	26.6	Jan
Hungary	+ 2.9	Q3	+ 7.6	Dec	+ 6.6	Jan	– 3.9	Dec	– 5.2	Dec	13.2	Jan
Poland	+ 3.9	Q3	+14.3	Jan	+ 1.7	Jan	– 9.7	Dec	– 3.2	Dec	32.6	Dec
Russia	+ 5.7	Q3	+ 7.5	Jan	+11.4	Jan	+60.0	Dec	+39.1	Q4	80.2	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 4.6	Q3	+ 9.5	Dec	+ 0.5	Jan	– 2.0	Dec	– 1.6	Q4	1.4	Dec
Latvia	+ 7.3	Q3	+ 5.5	Dec	+ 3.9	Jan	– 2.0	Dec	– 0.9	Dec	1.4	Dec
Lithuania	+10.6	Q4	na		– 1.3	Dec	– 2.6	Dec	– 1.1	Q3	3.4	Dec
Slovakia	+ 4.2	Q3	+ 3.5	Dec	+ 8.3	Jan	– 0.6	Nov	– 0.8	Sep	11.7	Dec
Slovenia	+ 2.3	Q3	+ 3.6	Dec	+ 4.0	Jan	– 0.8	Dec‡	nil	Dec	8.2	Nov
Pakistan	+ 5.1	2003†	+20.8	Oct	+ 5.2	Jan	– 1.4	Jan	+ 3.8	Q3†	11.0	Dec
Saudi Arabia	+ 1.0	2002	na		– 0.9	Sep	+41.8	2002	+11.9	2002	22.6	Dec

*Excluding gold, except Sinagpore; IMF definition. †Year ending June. ‡New series

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Feb 19th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 18th		Dec 31st 2002	
	Feb 18th	year ago	Feb 18th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	15.8	na	1,799.4	+2.3	+ 26.8	+ 26.8
Hong Kong	7.77	7.80	14.8	0.08	13,928.4	+3.0	+ 49.4	+ 50.0
India	45.2	47.7	86.1	4.33	6,027.0	+1.3	+ 78.5	+ 89.3
Indonesia	8,402	8,880	16,006	7.97	785.9	+2.1	+ 84.9	+ 97.0
Malaysia	3.80	3.80	7.24	3.03	857.2	+4.8	+ 32.6	+ 32.6
Philippines	56.1	54.3	106.9	9.13	1,472.1	−0.3	+ 44.6	+ 37.5
Singapore	1.68	1.75	3.19	0.75	1,888.5	+1.1	+ 40.8	+ 45.7
South Korea	1,152	1,191	2,195	4.01	877.1	+0.1	+ 39.8	+ 43.9
Taiwan	33.0	34.7	63.0	1.10	6,605.9	+2.3	+ 48.4	+ 56.1
Thailand	39.0	43.0	74.3	1.33	742.3	−1.4	+108.2	+130.1
Argentina	2.94	3.19	5.61	3.50	1,127.7	+9.5	+114.8	+145.7
Brazil	2.94	3.61	5.60	16.32	22,000.1	−5.2	+ 95.2	+135.3
Chile	574	748	1,093	1.68	7,429.0	+3.8	+ 48.0	+ 85.9
Colombia	2,698	2,936	5,140	7.93	3,068.3	+4.6	+ 90.7	+102.7
Mexico	10.9	10.8	20.8	5.60	10,125.0	+2.5	+ 65.3	+ 58.6
Peru	3.47	3.48	6.62	2.53	2,738.1	−1.7	+ 96.7	+ 99.0
Venezuela	3,019§	1,598	5,751	na	27,851.9	−1.0	+247.5	+ 59.6
Egypt	6.18	5.51	11.77	7.03	12,739.8	−8.1	+137.2	+ 77.7
Israel	4.44	4.86	8.45	1.26	572.7	+0.7	+ 72.3	+ 84.4
South Africa	6.56	8.30	12.5	8.05	10,935.5	+1.0	+ 17.9	+ 54.2
Turkey	1,321,500	1,636,000	2,517,458	21.00	19,478.7	+8.2	+ 87.8	+136.0
Czech Republic	25.5	29.4	48.6	2.06	748.4	+0.9	+ 62.4	+ 91.6
Hungary	204	229	389	12.74	9,837.5	−0.7	+ 26.1	+ 38.8
Poland	3.81	3.87	7.25	5.44	23,477.3	+0.9	+ 63.4	+ 64.6
Russia	28.5	31.6	54.3	14.00	655.2‡	+4.6	+ 62.7	+ 82.5
EMF (MSCI)*	1.00	1.00	1.91	na	483.2	+2.4	+ 65.4	+ 65.4
EMBI+†	1.00	1.00	1.91	na	297.2	−0.3	+ 29.9	+ 29.9

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms. § Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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